



UNITHOLDERS' QUARTERLY REPORT

Nine Months Ended September 30, 2007

LETTER TO UNITHOLDERS

On November 6, 2007, Extencicare Real Estate Investment Trust (“Extencicare REIT” or the “REIT”) (TSX: EXE.UN) reported net earnings of \$16.2 million for the 2007 third quarter compared with net earnings of \$1.7 million for the third quarter of 2006. Net earnings for both periods were affected by a number of separately reported gains and losses and other factors that are outlined in the attached Unitholders’ Report. Earnings before interest, income taxes, depreciation, amortization, and accretion (EBITDA) for the 2007 third quarter totalled \$51.4 million compared with \$48.0 million for the 2006 third quarter. Excluding a \$2.7 million negative impact of the stronger Canadian dollar, EBITDA improved \$6.1 million or 12.7% from the third quarter of last year.

Other financial highlights of our 2007 third quarter results and other developments include:

- Funds from operations (FFO) from continuing operations of \$24.6 million (\$24.4 million in 2007 second quarter);
- Adjusted funds from operations (AFFO) from continuing operations of \$22.2 million (\$21.9 million in 2007 second quarter);
- Average Medicare Part A rate of US\$392.42 (up 6.3% from 2006 third quarter, 0.9% from 2007 second quarter);
- U.S. nursing home same-facility average daily census (ADC) of 12,406 (1.0% lower than 2006 third quarter);
- Tendercare acquisition completed October 31, 2007; and,
- November distribution of \$0.0925 per unit declared.

During the third quarter of 2007, we achieved good progress with our strategy to increase revenue rates by serving a greater proportion of high-acuity residents with intense rehabilitative needs, particularly in the Medicare and private-pay segments of our business. Higher revenue rates were largely offset by a reduction in our Medicare and total ADC during the summer months when the volume of elective surgeries and other hospital procedures decline. We also continue to advance our growth program, both through acquisitions and the construction of new facilities.

Tendercare Acquisition

Extencicare Health Services, Inc. (EHSI) completed the acquisition of Tendercare (Michigan) Inc. and affiliated entities (collectively “Tendercare”) on October 31, 2007, for total consideration of US\$232.3 million, excluding transaction costs. The acquisition has added 30 senior care facilities and two projects under development to EHSI’s portfolio, and has established EHSI as a significant long-term care provider in the State of Michigan. During the first six months of 2007, Tendercare’s overall nursing home occupancy was 82.5%, Medicare census as a percent of total ADC was 15.0% and the average Medicare Part A rate was US\$377.14 per day. By comparison, over the first nine months of 2007, EHSI’s occupancy rate from nursing facilities was 90.2%, Medicare census was 18.5% and the average Medicare Part A rate was US\$389.69 per day.

Other Acquisitions

On August 1, 2007, EHSI acquired a Wisconsin assisted living facility (56 units) for US\$5.4 million in cash. At the end of the third quarter, EHSI acquired a 99-bed nursing facility in Wisconsin for cash of US\$7.4 million. An agreement entered into by EHSI to acquire a 60-bed skilled nursing facility and a 62-unit assisted living facility in Wausau, Wisconsin for cash of US\$15.7 million is targeted for closing before the end of 2007.

Construction Projects

As of September 30, 2007, EHSI had construction projects in progress in the U.S., representing 121 nursing home beds, of which 110 beds will be completed by the end of 2007, with the remainder by April 2008. The projects are comprised of a 100-bed nursing facility in Washington and a 21-bed nursing home addition in Ohio. The total estimated cost of these projects is US\$14.1 million, of which US\$8.3 million had been incurred through to September 30, 2007.

In Canada, Extencicare (Canada) Inc. (ECI) has entered into agreements to construct, own and operate a 280-bed continuing care centre in the city of Red Deer, Alberta. The Red Deer facility is anticipated to be completed by the end of 2009 at an estimated net cost of approximately \$36.3 million, net of government grants.

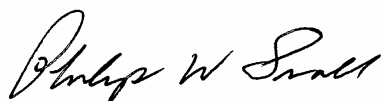
ECI has also been selected by the Government of Ontario to construct, own and operate three nursing homes (480 beds). Construction of the first, a 160-bed nursing home in Kingston, is anticipated to begin in May 2008 for completion by the end of 2009 at an estimated cost of \$24.0 million. ECI also expects to manage an additional 160-bed facility in Windsor that was awarded to a partner.

November Distribution

On November 6, 2007, the Board of Trustees of the REIT declared a cash distribution of \$0.0925 per unit for the month of November 2007, payable to unitholders of record at the close of business on November 30, 2007, and will be paid on December 17, 2007. Management estimates that approximately 70% of Extencicare REIT's distributions in 2007 will be characterized as tax deferred returns of capital. To the extent a portion of the remaining 30% of the 2007 distributions are dividends, those paid to Canadian residents will be eligible dividends as per the Canadian Income Tax Act.

Going forward, Extencicare REIT's key business goals are to stay focused on our core values of providing quality care to residents, providing an energizing work environment for our employees and creating long-term value for our unitholders through strong operating performance, accretive acquisitions and attractive construction projects.

Sincerely,



Philip W. Small
President and Chief Executive Officer

Forward-looking Statements

Information provided by Extencicare REIT from time to time, including this report, contains or may contain forward-looking statements concerning anticipated financial 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", "objective" "project" or other similar expressions. Forward-looking statements reflect management's beliefs and assumptions and are based on information currently available, and the REIT assumes no obligation to update any forward-looking statement. These statements are not guarantees of future performance and 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. Given these risks and uncertainties, readers are cautioned not to place undue reliance on the REIT's forward-looking statements. Further information can be found in the disclosure documents filed by Extencicare REIT with the securities regulatory authorities, available at www.sedar.com and on the REIT's website at www.extencicare.com.

MANAGEMENT'S DISCUSSION AND ANALYSIS

November 6, 2007

Basis of Presentation

The consolidated financial results include those of Extencicare Real Estate Investment Trust and its subsidiaries. References to "Extencicare REIT" or the "REIT" 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 facilities and ancillary businesses is conducted by the subsidiaries of the REIT. The REIT itself is not a provider of services or products.

Extencicare REIT is the successor in interest to Extencicare Inc. ("Extencicare" or the "Company") resulting from the conversion of Extencicare to a real estate investment trust on November 10, 2006 pursuant to a plan of arrangement (the "Arrangement"). Extencicare REIT is an unincorporated, open-ended limited purpose trust established under the laws of the Province of Ontario pursuant to a deed of trust, dated September 11, 2006, as amended and restated on October 28, 2006 (the "Deed of Trust"). Extencicare REIT trades on the Toronto Stock Exchange (TSX) under the symbol "EXE.UN". 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. Commencing with the year ended December 31, 2006, comparative information for the REIT relating to periods prior to the conversion is that of its predecessor, Extencicare Inc.

The Arrangement included the distribution of Assisted Living Concepts, Inc. (ALC) to Extencicare's shareholders. As a result, the financial results for 2006 and prior periods reflect ALC as a discontinued operation. As well, Extencicare conducted a number of pre-Arrangement transactions to position itself for the Arrangement. References to the "Reorganization" in this document are to the Arrangement completed on November 10, 2006, and the pre-Arrangement transactions as described under the heading "Significant Developments – 2006 Reorganization".

This Management's Discussion and Analysis of Results of Operations and Financial Position (MD&A) describes the REIT's business, the business environment, the principal factors affecting the results of operations, liquidity and capital resources, and the critical accounting policies of the REIT that will help the reader understand the consolidated financial results. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect the REIT in the future. This MD&A should be read in conjunction with Extencicare REIT's unaudited interim consolidated financial statements for the nine months ended September 30, 2007, and the notes thereto, together with the MD&A and the audited consolidated financial statements and accompanying notes for the year ended December 31, 2006 found in the REIT's 2006 Annual Report. 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, 2006, or December 31 of the year referenced.

Certain comparative figures have been reclassified to conform to the presentation in 2007, mainly for discontinued operations identified in 2007.

Executive Overview

Extencicare REIT, through its wholly owned subsidiary operating entities, is a major provider of long-term care and related services in North America.

On October 31, 2007, Extencicare Health Services, Inc. completed the acquisition of Tendercare (Michigan) Inc. and affiliated entities (collectively "Tendercare"), a private nursing home operator in the State of Michigan (see "Significant Developments – Acquisitions Completed and Pending"), following which Extencicare now operates 267 senior care facilities with capacity for approximately 30,200 residents.

The REIT's wholly owned U.S. subsidiary, Extencicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates nursing and assisted living facilities in the United States. EHSI offers a continuum of health care services, including nursing care, assisted living and related medical specialty services, such as subacute care and rehabilitative therapy on an inpatient and outpatient basis.

Management's Discussion and Analysis

The REIT's wholly owned subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI"), operates nursing and retirement centres in Canada, and also manages a chronic care hospital unit in Ontario. ECI is a major provider of home health care in Canada through its ParaMed Home Health Care (ParaMed) division.

At September 30, 2007, Extendicare operated 236 senior care facilities with capacity for 26,881 residents (December 31, 2006 – 234 facilities with capacity for 26,836; September 30, 2006 – 441 facilities with capacity for 35,082 residents, which included 206 ALC facilities). The number of facilities operated at September 30, 2007, has fluctuated during the first nine months of 2007 due to the designation in the 2007 first quarter of one Ohio nursing facility (175 beds) as discontinued and the following acquisitions: a 191-bed Wisconsin nursing home in May (111 beds are not currently operational); a 56-unit Wisconsin assisted living facility in August; and a 99-bed Wisconsin nursing home at the end of September. In addition, the operational capacity at other facilities was adjusted during 2007.

EHSI has a significant presence (more than 15% of its resident capacity) in each of Pennsylvania, Ohio, and subsequent to the closing of the Tendercare acquisition on October 31, 2007, Michigan. As well, ECI's senior care facilities have a significant presence in Ontario, where 77% of its residents are served. EHSI's average occupancy from continuing nursing home operations was 90.2% in the first nine months of 2007 compared to 91.5% in the first nine months of 2006, and to 91.3% for the 2006 year. ECI's average occupancy in its senior care facilities was 98.2% in the first nine months of 2007 compared to 98.1% in the first nine months of 2006 and for the 2006 year.

Extendicare remains committed to its core senior care operations, while continuing to grow its complementary long-term care services. Nursing and assisted living centre revenue represented approximately 89% of Extendicare's revenue from continuing operations for the first nine months of 2007, as well as for the 2006 year. Management will continue its strategy to grow the business through selective acquisitions and new development projects.

The principal elements of Extendicare's business strategy are to: provide quality, clinically-based services; increase average daily revenue rates, particularly in the Medicare and managed care (private-pay) segments, by focusing on high-acuity, medically-complex residents; strengthen both Medicare and private-pay census as a percentage of total average daily census (ADC); increase market share of Canadian home health care operations; improve operating cash flow; actively improve its asset portfolio through renovation, expansion or acquisition, or where appropriate through disposal of underperforming facilities; expand non-government based revenue sources, thereby decreasing the level of risk and reliance on government funding; diversify within the long-term care industry in the areas of rehabilitative clinics and management and consulting services; increase operating efficiency; and manage resident care liability claim settlements.

In preparation for the January 1, 2006, changes to the Resource Utilization Groupings (RUGs) classifications implemented by the Centers for Medicare & Medicaid Services (CMS), which included the discontinuance of funding under the "RUGs Refinement" enhancements and implementation of nine new RUGs classifications, EHSI refocused its marketing strategies to target residents requiring short-term rehabilitative services and trained its clinical staff to ensure that it could accurately assess its residents in accordance with the changes. As a result, though EHSI experienced a decline in census during 2006, it was successful in not only recovering the loss from the RUGs Refinement enhancements, but also increasing its average Medicare rates. Despite the loss of the RUGs Refinement enhancements, EHSI's average Medicare Part A rate increased from US\$362.99 in the 2005 fourth quarter to US\$369.12 in the 2006 third quarter, which was prior to any rate increases. On October 1, 2006, Medicare Part A rates increased by 3.1% as part of the annual inflationary increase, resulting in EHSI's average Medicare Part A rate increasing to US\$382.78 in the 2006 fourth quarter.

In 2007 EHSI's average Medicare Part A rate increased further to US\$392.42 for the 2007 third quarter due to changes in patient mix. For the 2007 third quarter, approximately 37.5% of EHSI's Medicare residents were classified within the nine new high acuity RUGs classifications compared to 35.2% for the 2006 third quarter and to 37.6% in the 2007 second quarter. As well, the percentage of therapy residents increased to 85.3% in the 2007 third quarter from 85.0% in the 2006 third quarter.

| U.S. Nursing Homes (continuing operations) | 2007 | | | 2006 | | | | 2005 | | | |
|---|---------------|---------------|---------------|--------|--------|--------|--------|--------|--------|--------|--------|
| | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Average Medicare Part A rate (US\$) | 392.42 | 388.93 | 387.95 | 382.78 | 369.12 | 369.48 | 367.64 | 362.99 | 344.78 | 343.08 | 340.47 |

Management's Discussion and Analysis

The following table provides the quarterly same-facility ADC for Medicare patients and total residents served in EHSI's nursing homes for 2007 and 2006.

| U.S. Nursing Homes <i>(same-facility basis)</i> | 2007 | | | | 2006 | | | | |
|--|--------|--------|--------|--------------|--------|--------|--------|--------------|--------|
| | Q1 | Q2 | Q3 | YTD Sept. | Q1 | Q2 | Q3 | YTD Sept. | Q4 |
| Medicare ADC | 2,379 | 2,347 | 2,129 | 2,284 | 2,378 | 2,293 | 2,230 | 2,300 | 2,296 |
| Total ADC | 12,515 | 12,453 | 12,406 | 12,458 | 12,694 | 12,565 | 12,537 | 12,598 | 12,557 |

EHSI's Medicare ADC on a same-facility basis was 2,129 in the 2007 third quarter compared to 2,230 in the 2006 third quarter. Contributing to the reduction was a seasonal decline in elective surgeries and other hospital procedures, which in 2006 had been experienced more in the second quarter than the third quarter. For the first nine months of 2007, Medicare ADC on a same-facility basis of 2,284 was similar to the 2,300 level for the first nine months of 2006.

EHSI's total U.S. nursing home ADC on a same-facility basis declined by 1.0% in the 2007 third quarter to 12,406 from 12,537 in the 2006 third quarter, and by 1.1% for the first nine months of 2007 to 12,458 from 12,598 for the first nine months of 2006.

For further details on the significant transactions affecting the 2007 results, refer to "Significant Developments", and for an analysis of the REIT's financial results, refer to the discussions under "Summary of Quarterly Results", "2007 Third Quarter Results" and "2007 Nine Month Results".

Critical Accounting Policies and Estimates

The REIT's consolidated financial statements have been prepared in accordance with Canadian GAAP. For a full discussion of the REIT's critical accounting policies and estimates, readers should refer to the MD&A of the REIT's 2006 Annual Report. The disclosures in such report have not materially changed since that report was filed; however, to the extent there have been changes in accounting policies or management's estimates, they are discussed under "Significant Developments" and under "Changes in Accounting Policies". Management considers an understanding of the REIT's accounting policies to be essential to an understanding of the REIT's financial statements because their application requires significant judgement and reliance on estimations of matters that are inherently uncertain. There is measurement uncertainty relating to the accounting policies applied to: revenue recognition and the valuation of accounts receivable; the measurement of acquired assets and assumed liabilities in business combinations; the valuation of assets and determination of asset impairment; the valuation of conditional asset retirement obligations; the accrual for self-insured liabilities; and the valuation for future income tax assets and liabilities.

Significant Developments

The following have had a significant effect on the financial results of Extencicare REIT for the first nine months of 2007 in comparison to the same period for 2006.

2006 Reorganization

On November 10, 2006, Extencicare completed the Arrangement that involved the distribution of ALC to the shareholders of Extencicare and the conversion of Extencicare into a Canadian real estate investment trust. Extencicare REIT, through its subsidiary operating entities, owns and continues to operate Extencicare's U.S. and Canadian nursing home businesses, a smaller number of assisted living facilities than were operated by Extencicare prior to November 10, 2006, and related businesses of Extencicare.

Pursuant to the terms of the Arrangement, holders of Subordinate Voting Shares of Extencicare ultimately received for each share (a) one Class A share of ALC, and (b) one unit of Extencicare REIT (REIT Unit) or, one Class B limited partnership unit (Exchangeable LP Unit) of Extencicare Limited Partnership (Extencicare LP); and holders of Multiple Voting Shares of Extencicare ultimately received for each share (a) one Class B share of ALC, and (b) 1.075 REIT Units or, 1.075 Exchangeable LP Units. The Exchangeable LP Units are not listed on a stock exchange, they are exchangeable for REIT Units at the option of the holder on a one-for-one basis, are entitled to vote with the holders of REIT Units pursuant to the Special Voting Units of the REIT, and are intended to be, to the greatest extent practicable, the economic equivalent of the REIT Units.

Management's Discussion and Analysis

Prior to the implementation of the Arrangement, Extencicare carried out certain pre-Arrangement transactions including:

- the transfer by EHSI to ALC of 29 assisted living properties that were formerly owned and operated by EHSI;
- other cash and non-cash capital contributions to ALC by EHSI;
- the transfer by EHSI of the shares of ALC to Extencicare;
- the prepayment by EHSI of all amounts owing by it under its existing term loan and credit facility, its 9.5% Senior Notes due July 1, 2010, (the "2010 Notes"), its 6.875% Senior Subordinated Notes due May 1, 2014, (the "2014 Notes") with the proceeds from the completion of a commercial mortgage backed securitization transaction and a new revolving line of credit;
- the termination by EHSI of its interest rate swap and cap agreements relating to the 2010 Notes and 2014 Notes; and
- the redemption of its preferred shares.

Transfer of ALC Shares by EHSI to Extencicare and Distribution to Extencicare's Shareholders

On November 10, 2006, all of the shares of ALC were transferred by EHSI to Extencicare at fair market value for U.S. tax purposes. Management has estimated income taxes payable of \$115.9 million (US\$102.5 million) in connection with the gain arising on the transfer of ALC by EHSI to Extencicare. Management believes the final determination of the capital gains tax will be based on the volume weighted average trading price of the ALC Class A Shares on its first day of trading, which was US\$8.00 on November 10, 2006. The U.S. Internal Revenue Service is not obliged to accept management's methodology for determining the fair market value of ALC. Each one dollar increase or decrease in the price of the ALC Class A Shares used to determine the fair market value of ALC for U.S. income tax purposes would result in a corresponding increase or decrease of approximately US\$30.0 million in EHSI's U.S. income tax liability.

Subsequent to the transfer of all of the shares of ALC by EHSI to Extencicare, the shares of ALC were distributed by Extencicare to its shareholders on November 10, 2006. The distribution was reflected as a charge to retained earnings of \$476.5 million.

Canadian Federal Income Tax on Income Trusts

On October 31, 2006, the Minister of Finance (Canada) (the "Minister") announced proposals to alter the taxation regime applicable to certain publicly traded entities that are specified investment flow-through trusts or partnerships (SIFTs) and their investors. On December 21, 2006, the Minister released draft legislation that contained amendments to the Income Tax Act (Canada) to implement the proposals. Bill C-52, which incorporated the proposed SIFT legislation (the "SIFT Rules"), received Royal Assent on June 22, 2007.

The new taxation regime will not apply to a "real estate investment trust" (a "REIT" as defined under the SIFT Rules) that meets prescribed conditions relating to the nature of its income and investments. As it is currently structured, Extencicare REIT does not meet the conditions to qualify as a REIT under the SIFT Rules and is therefore a SIFT.

The legislation is effective with the 2007 taxation year for a SIFT unless the SIFT qualifies as an "existing trust" under the SIFT Rules, in which case the SIFT is eligible for transitional relief from the SIFT tax through 2010. Extencicare REIT does not qualify as an "existing trust", because its units were not publicly listed prior to November 1, 2006. As a result, Extencicare REIT is subject to the SIFT tax commencing January 1, 2007.

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 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. Distributions paid by a SIFT as returns of capital will not be subject to the distribution tax contained in the SIFT Rules.

Beginning with its 2007 second quarter results, Extencicare REIT recorded a provision for SIFT tax. Based on the REIT's current structure, operations and level of return of capital, its understanding of the SIFT Rules and certain assumptions, management has recorded a provision of \$3.5 million, or \$0.05 per diluted unit, for SIFT tax for the nine months ended September 30, 2007.

Management's Discussion and Analysis

Approximately 73% of Extencicare REIT's distributions in 2006 were characterized as tax deferred returns of capital in Extencicare REIT's indirect investment in its subsidiaries. Management believes that it is likely that approximately 70% of Extencicare REIT's distributions in 2007 will also be characterized as tax deferred returns of capital. The adjusted cost base of the REIT Units held by a unitholder will generally be reduced by such non-taxable portion of distributions that are made to the unitholder. No assurance can be given that the composition of distributions by Extencicare REIT for tax purposes will not be changed from that described above. Any change in such composition of the REIT's distributions will affect its unitholders' after tax return.

The current policy of each of Extencicare REIT and Extencicare LP is to pay distributions of \$0.0925 per REIT Unit and Exchangeable LP Unit, respectively, to 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 Extencicare REIT and its subsidiaries, debt covenants and obligations, and other factors deemed relevant by the Board of Trustees.

Financings

2007

On January 19, 2007, ECI received \$26.3 million of Canada Mortgage and Housing Corporation (CMHC) financing secured by three of its Canadian nursing facilities. The three loans have 10-year terms with weighted average monthly payments amortized over 20 years at 4.67%.

On March 6, 2007, EHSI raised US\$90.0 million from the completion of a second commercial mortgage backed securitization loan due 2012 (the "2012 CMBS Financing"), with a fixed interest rate of 6.79%. The 2012 CMBS Financing has a 5-year term and stipulates monthly payments of interest only for the first two years, and thereafter monthly payments of principal and interest based upon a 25-year amortization period. The 2012 CMBS Financing is collateralized by first mortgages on 14 of EHSI's skilled nursing facilities, and all other assets owned by these facilities including personal property and receivables. The proceeds from the 2012 CMBS Financing were used primarily to cover current taxes payable on the sale of ALC by EHSI to Extencicare.

On June 21, 2007, the REIT completed a public offering of \$115.0 million of 5.70% convertible subordinated unsecured debentures, with a \$19.90 conversion price, due June 30, 2014 (the "2014 Debentures"). The net proceeds from the 2014 Debentures were approximately \$109.3 million, after the payment of issue related costs of approximately \$5.7 million, of which \$49.4 million (US\$46.0 million) was used to repay the balance outstanding under EHSI's revolving line of credit. The balance of the net proceeds was partially used to finance the Tendercare acquisition in October 2007, and the remainder will be used to finance other strategic acquisitions, internal growth, and for other general business purposes.

On June 29, 2007, Extencicare amended its revolving line of credit with Royal Bank of Canada (the "RBC Credit Facility") to increase its availability from \$50.0 million to \$70.0 million. The RBC Credit Facility is due on demand, is secured by 14 Canadian nursing homes, and is guaranteed by certain Canadian operating subsidiaries of Extencicare. It is primarily used to back letters of credit, of which there were \$63.9 million issued and outstanding as at September 30, 2007, leaving \$6.1 million available. The letters of credit secure \$45.1 million of Extencicare's pension obligations and \$18.8 million of Extencicare's obligations for contingent liabilities in connection with the sale of Extencicare's investment in Crown Life Insurance Company (Crown Life) (see "Investment in Crown Life Insurance Company").

2006

In October 2006 ECI refinanced a \$9.9 million mortgage that had matured, with CMHC financing, for a term of 10 years at a rate of 4.63%, under a 20-year amortization schedule.

As part of the Reorganization in the 2006 fourth quarter, EHSI repaid its 2010 Notes in the principal amount of US\$150.0 million, its 2014 Notes in the principal amount of US\$125.0 million, and its term loan and revolving credit facility in the amount of US\$164.9 million with proceeds from the completion on October 16, 2006 of a US\$500.0 million commercial mortgage backed securitization transaction (the "2011 CMBS Financing"). At the same time, EHSI amended its credit facility to provide for borrowings of up to US\$120.0 million (the "Credit Facility"). Proceeds from the financings were also used to cover prepayment penalties, terminate interest rate lock, swap and cap agreements, and pay related transaction costs.

Management's Discussion and Analysis

The 2011 CMBS Financing has a 5-year term, with a fixed interest rate of 6.6525%, with monthly interest only payments for the first three years, and principal and interest payments for the last two years, based upon a 25-year amortization period. The 2011 CMBS Financing is collateralized by a first mortgage on 86 of EHSI's skilled nursing facilities, and all other assets owned by these facilities including personal property and receivables.

Under both the 2011 and 2012 CMBS Financings, EHSI is required to maintain: (1) a consolidated leverage ratio (exclusive of any notes owing to Extencicare REIT and its subsidiaries) of less than 5.5 to 1.0; (2) a consolidated fixed charge ratio of at least 1.50 to 1.00; and (3) a minimum consolidated tangible net worth computed by capitalizing net cash flow for the last 12 months. EHSI is in compliance with these requirements as of September 30, 2007. 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.

EHSI's Credit Facility has a 3-year term, no required principal repayments, and floating-rate interest based on a pricing grid. The interest rate margins range based upon EHSI's consolidated leverage ratio. The margin over the Eurodollar rate ranges from 1.5% to 2.5%, or 0.5% to 1.5% over the base rate, as applicable. The Credit Facility has 24 skilled nursing facilities as specific collateral and is guaranteed by Extencicare Holdings, Inc. (EHSI's parent company) and EHSI's material domestic subsidiaries. The Credit Facility is used to back letters of credit and for general corporate purposes.

Under the Credit Facility, EHSI is required to comply with various financial covenants, including fixed charge coverage, debt leverage, and tangible net worth ratios. The Credit Facility 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 loans under the Credit Facility, charge a default rate of interest, and/or foreclose on the mortgages and other collateral securing the Credit Facility. EHSI is permitted to make voluntary prepayments at any time under the Credit Facility.

The amount available to be borrowed under EHSI's Credit Facility is the lesser of: (1) 60% of the appraised values of the nursing facilities collateralizing the Credit Facility, or (2) an amount based on the actual net cash flow of these facilities for the last 12 months. The amount available to be borrowed as of September 30, 2007 was US\$95.1 million, of which EHSI had US\$7.5 million drawn and US\$17.5 million securing outstanding letters of credit, leaving the unused portion of the Credit Facility at US\$70.1 million.

Acquisitions Completed and Pending

2007

On January 5, 2007, EHSI completed the acquisition of a nursing facility (111 beds) in Ohio, which it had been operating under a lease arrangement, for cash of \$8.7 million (US\$7.4 million).

In May 2007 EHSI acquired a nursing facility in Milwaukee, Wisconsin (191 licensed beds) for cash of \$2.8 million (US\$2.5 million). EHSI is operating the facility as an 80-bed nursing facility and plans to relocate the remaining beds to another facility.

On August 1, 2007, EHSI acquired a Wisconsin assisted living facility (56 units) for \$5.8 million (US\$5.4 million) in cash.

At the end of September 2007, EHSI acquired a 99-bed nursing facility in Wisconsin for cash of \$7.3 million (US\$7.4 million).

Subsequent to September 30, 2007

On October 31, 2007, EHSI completed the acquisition of Tendercare in accordance with the previously announced May 9, 2007, purchase and sale agreement. Total consideration for the transaction, including assumption of debt, was US\$232.3 million (excluding transaction costs), comprised of US\$196.0 million for Tendercare's 30 operating senior care facilities (approximately US\$60,000 per operational bed), US\$6.0 million for two skilled nursing facilities under development, and US\$30.3 million for existing working capital (including US\$20.5 million of cash). The consideration includes the assumption of existing debt of US\$76.6 million with a weighted average interest rate of 6.85%, the issuance of US\$26.4 million of 7.5% seller notes, and US\$129.3 million in cash. Seller notes of US\$16.0 million are paid commencing on the third anniversary date at US\$4.0 million per annum until maturity in 2013; whereas the balance of the notes of US\$10.4 million is paid based upon certain factors being met but have a term of no longer than 18 months. Further details of the acquisition are provided in note 16 of the unaudited consolidated financial statements for the nine months ended September 30, 2007.

Management's Discussion and Analysis

The Tendercare portfolio acquired is comprised of 30 senior care facilities (approximately 3,300 operational beds), which includes 29 skilled nursing facilities and one inpatient rehabilitation hospital. As well, Tendercare currently has two skilled nursing facilities under development (177 beds), one of which is expected to be completed by the end of 2007, and the other in the third quarter of 2008. In addition, EHSI will manage an assisted living facility (51 units), which will continue to be owned by the previous shareholders of Tendercare.

Based on the portfolio's current performance, the transaction is expected to contribute approximately US\$220.0 million of revenue, US\$22.0 million of earnings before interest, income taxes, depreciation, amortization and accretion (EBITDA) and between \$0.05 and \$0.06 per diluted unit of adjusted funds from operations (AFFO) to Extencare REIT's annual consolidated financial results. Tendercare's Medicare census as a percent of total average daily census was 15.0%, the average Medicare Part A rate was US\$377.14 per day, and overall nursing home occupancy was 82.5% in the first six months of 2007.

Pending

In August 2007 EHSI entered into an agreement to acquire a 60-bed skilled nursing facility and a 62-unit assisted living facility in Wausau, Wisconsin for cash of US\$15.7 million, to be completed on December 1, 2007.

2006

In 2006 EHSI acquired the following nursing facilities for cash of \$50.2 million (US\$44.2 million): an Ohio nursing facility it had been leasing (150 beds) on December 11, 2006; three nursing facilities (259 beds) in Kentucky on August 1, 2006; and two nursing facilities (417 beds) in Pennsylvania on March 1, 2006.

Construction

United States

EHSI implemented a construction program in 2003 to expand its existing portfolio of nursing and assisted living facilities. All of the assisted living projects under this construction program formed part of the ALC operations that were distributed. With respect to the expansion of its skilled nursing homes, EHSI completed three additions in the 2006 third quarter, adding capacity for 64 beds.

As of September 30, 2007, EHSI had construction projects in progress, representing 121 nursing home beds, of which 110 will be completed by the end of 2007, with the remainder by April 2008. The projects are comprised of a 100-bed nursing facility in Washington and a 21-bed nursing home addition in Ohio. The total estimated cost of these projects is US\$14.1 million. Costs incurred through September 30, 2007 on these projects were approximately US\$8.3 million and purchase commitments of US\$4.1 million are outstanding.

Canada

In April 2007 ECI entered into an agreement with the local Regional Health Authority (David Thompson Health Region) to construct, own and operate a 280-bed continuing care centre in the city of Red Deer, Alberta. The centre will be part of a seniors' community that will include an independent living housing complex being developed by a third party. The estimated cost of this 280-bed project, net of government grants, is approximately \$36.3 million. ECI is in the process of securing financing for the project. The new facility is anticipated to be completed by the end of 2009.

During 2007 ECI was awarded three projects representing 480 long-term care beds under the Ontario government's October 2006 emergency room wait time strategy that included the construction of 1,750 new and the replacement of 662 long-term care beds. In May 2007, under the first round of proposals for three of the projects, ECI was awarded a project for 160 long-term care beds in Kingston, Ontario. Construction of the Kingston nursing home is anticipated to cost approximately \$24.0 million, or \$150,000 per bed, for completion by the end of 2009. In addition, ECI is in the planning stages of a 100-bed assisted living facility on the same property as the Kingston nursing home. The other two nursing home projects awarded to ECI were announced in August and September of 2007, and represent 192 long-term care beds in Guelph and 128 long-term care beds in Windsor. In addition, ECI expects to manage an additional 160-bed nursing home in Windsor that was awarded to a partner. These projects are still in the planning stages, but are anticipated to be completed in 2010. ECI is in the process of securing financing for the projects. Once the nursing homes are opened, they are eligible for government capital funding at \$10.35 per bed per day over a 20-year period.

Management's Discussion and Analysis

ECI is also in the planning stages to construct a 140-unit assisted living facility in Lethbridge, Alberta as a replacement for an existing 120-bed nursing home that ECI operates in the region. The cost of the new facility, net of government grants, is estimated to be approximately \$20.0 million. The new facility is anticipated to be completed at the end of 2009.

Loss (Gain) on Derivative Financial Instruments and Foreign Exchange

For the first nine months of 2007, the REIT reported a pre-tax gain of \$20.5 million, of which \$3.4 million was recorded in the 2007 third quarter, related to the valuation of derivative financial instruments and foreign exchange gains. The amount included a foreign exchange gain of \$5.2 million realized primarily on settlement of intercompany borrowings between the Canadian and U.S. operations. The valuation of foreign currency forward contracts entered into by EHSI resulted in a gain of \$15.3 million for the first nine months of 2007. EHSI has entered into two forward contracts to acquire Canadian dollars on a monthly basis to June 2010. The first contract locks in EHSI's exchange rate to acquire Canadian dollars for US\$4.0 million each month at 1.1141 for a 36-month period that commenced in December 2006 and ends in November 2009. In June 2007, EHSI entered into an additional foreign currency forward contract to cover the 7-month period from December 2009 to June 2010. This contract provides for a range of exchange rates on acquiring Canadian dollars for US\$4.0 million each month, with the floor rate set at 1.00, the ceiling rate set at 1.1050, and the current exchange rate applied if it falls between these two rates. In addition, in September 2007, EHSI entered into a foreign currency forward contract under which it locked in the purchase of US\$76.2 million in exchange for \$80 million for settlement in October 2007, which was delivered via an intercompany advance from the Canadian operations from cash on hand to finance the Tendercare acquisition. As of September 30, 2007, the fair value of the foreign currency forward contracts was an asset of \$9.4 million (US\$9.4 million).

For the first nine months of 2006, the REIT reported a pre-tax loss of \$16.2 million, of which \$16.6 million was recorded in the 2006 third quarter, related to the valuation of interest rate caps of \$1.0 million, and \$15.2 million on valuation of an interest rate lock agreement in connection with the 2011 CMBS Financing, both of which were settled in October 2006.

For the year ended December 31, 2006, the REIT reported a pre-tax charge of \$66.8 million on the valuation of derivative financial instruments and a foreign exchange loss. A foreign exchange loss of \$40.3 million occurred on the net reduction of the U.S. net assets resulting from the payment of a dividend and the settlement of an intercompany note that originated as part of the Reorganization. The valuation and termination of derivative financial instruments resulted in a loss of \$26.5 million related to: a loss of \$11.8 million on settlement of an interest rate lock agreement that EHSI entered into in connection with securing the 2011 CMBS Financing; a loss of \$9.5 million related to the valuation and subsequent settlement of EHSI's interest rate swap and cap arrangements; and a loss of \$5.2 million related to the valuation of EHSI's foreign currency forward contract.

Loss (Gain) from Restructuring Charges, Asset Disposals and Other Items

The REIT reported a pre-tax gain of \$2.2 million for the nine months ended September 30, 2007, related to the disposal of real estate with no book value.

For the three and nine months ended September 2006, the REIT reported a pre-tax charge of \$12.8 million and \$18.5 million, respectively, primarily related to restructuring charges associated with the Reorganization. For the year ended December 31, 2006, this amount was \$55.2 million of which \$53.8 million related to the Reorganization.

A summary of the pre-tax charges booked for the three and nine months ended September 2007 and 2006, and for the 2006 year is outlined in the table below on a consolidated and divisional basis.

| <i>(millions of dollars)</i> | Three months ended September | | Nine months ended September | | Year |
|--|---------------------------------|------|--------------------------------|-------|---------------------|
| | 2007 | 2006 | 2007 | 2006 | 2006 |
| Consolidated | | | | | |
| Restructuring charges | – | 11.7 | – | 16.7 | 53.8 |
| Other | – | 1.1 | 2.2 | 1.8 | 1.3 |
| | – | 12.8 | 2.2 | 18.5 | 55.2 ⁽¹⁾ |
| U.S. Operations | | | | | |
| Restructuring Charges | | | | | |
| Transaction costs of reorganization | – | 1.8 | – | 1.8 | 2.3 |
| Retirement of debt | | | | | |
| Tender and call premiums | – | – | – | – | 18.7 |
| Write-off of deferred financing costs | – | – | – | – | 10.3 |
| Bond discount written off and foreign exchange | – | – | – | – | 3.1 |
| Legal expenses | – | – | – | – | 0.9 |
| | – | 1.8 | – | 1.8 | 35.3 |
| Other | | | | | |
| Loss on investment in Omnicare | – | 0.3 | – | 0.4 | 0.4 |
| Loss related to abandoned assisted living project | – | 0.7 | – | 0.7 | 0.7 |
| Gain on sale of non-core assets | – | – | 2.2 | – | (0.5) |
| Provision for impairment of U.S. long-lived assets | – | 0.1 | – | 0.1 | 0.1 |
| | – | 1.1 | 2.2 | 1.2 | 0.7 |
| Total U.S. operations | – | 2.9 | 2.2 | 3.0 | 36.0 |
| Canadian Operations | | | | | |
| Restructuring charges | – | 9.9 | – | 14.9 | 18.5 |
| Other | | | | | |
| Gain on sale of non-core assets | – | – | – | (0.2) | (0.2) |
| Provision for severance | – | – | – | 0.8 | 0.8 |
| | – | – | – | 0.6 | 0.6 |
| Total Canadian operations | – | 9.9 | – | 15.5 | 19.2 ⁽¹⁾ |
| | – | 12.8 | 2.2 | 18.5 | 55.2 |

⁽¹⁾ Does not add due to rounding.

Discontinued Operations

Extencare 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 market 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 September 30, 2007, EHSI had assets held for sale of \$7.0 million (US\$7.0 million) related to four nursing facilities in Texas leased to a third party and one closed nursing facility in Ohio.

As well, the operations of ALC have been accounted for by the REIT as discontinued as a result of the Arrangement.

During the 2007 first quarter, due to poor financial performance, EHSI decided to voluntarily close a 175-bed nursing home in Ohio, and sell the property. EHSI recorded an impairment charge of \$6.0 million (US\$5.1 million) to reduce the property value to US\$0.3 million. The comparative figures presented have been revised to reflect these operations as discontinued.

Discontinued operations reported a loss of \$4.0 million for the first nine months of 2007, which included the operations and impairment charge of the Ohio nursing facility, the operations of the leased properties in Texas, and a pre-tax recovery of \$0.2 million on the sale of an assisted living property in Texas for \$2.2 million in cash. In addition, EHSI completed the transfer of a closed Wisconsin nursing home to a non-profit organization, with no gain or loss on sale.

For the first nine months of 2006, discontinued operations reported earnings of \$5.5 million, which included the operations of ALC. Earnings from discontinued operations were \$7.7 million for the 2006 year and included: the operations of: ALC; other assisted living facilities primarily in Texas and Washington; skilled nursing facilities in Wisconsin, Minnesota and Oregon; and leased properties in Florida and Texas.

EHSI leased 12 nursing properties in Texas from Triple S Investment Company (Triple S) that were subleased to Senior Health Properties – Texas, Inc. (Senior Health – Texas), along with the four Texas properties that EHSI owned. EHSI had made guarantees to Triple S for the payment of operating leases by Senior Health – Texas. In December 2006 EHSI made the decision in conjunction with Triple S to dispose of these facilities. On November 2, 2007, EHSI and Triple S completed the sale of all 16 Texas properties to an unrelated party, thereby terminating EHSI's obligations under its lease agreement with Triple S. The net proceeds from the sale of EHSI's four properties approximate their \$7.0 million carrying value reflected in assets held for sale.

Investment in Crown Life Insurance Company

As previously announced, Extencare completed the sale of its approximate 35% equity interest in Crown Life on July 5, 2007, for an aggregate \$86.1 million, net of transaction costs. The consideration included a dividend from Crown Life in June and a cash payment from The Canada Life Assurance Company (Canada Life) for the shares of Crown Life in July. Post closing adjustments were agreed to at the end of September, with the final cash settlement of \$1.1 million received by Extencare in October. Extencare also completed a purchase and sale with HARO Financial Corporation (HARO) of certain securities received by it and HARO on the Crown Life dividend in June. As a result of these transactions, Extencare received cash of \$82.5 million, net of transaction costs, and securities valued at \$3.6 million.

Under the Crown Life share sale agreement with Canada Life entered into on June 8, 2007, Extencare remains responsible for certain possible specified contingent claims against Crown Life of up to approximately \$18.8 million and in support of the claims, has delivered letters of credit to Crown Life in such amount. In order to secure the letters of credit, Extencare amended its RBC Credit Facility to increase the availability to \$70.0 million from \$50.0 million. Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. The post closing adjustments included an adjustment to the contingent liabilities. As a result, management now estimates that Extencare's aggregate liability for such claims will not exceed \$8.0 million, and has recorded a provision for this amount in other long-term liabilities on the balance sheet as of September 30, 2007.

Update of U.S. Legislative Actions Affecting Revenue

The majority of Extencare's operations are in the United States where 68.5% of its revenue was earned in the first nine months of 2007. EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, as well as from private payors. Private-pay revenue includes payments from individuals, commercial insurers, health maintenance organizations, preferred provider organizations and other charge-based payment sources, including Blue Cross associations and the Department of Veterans Affairs.

Management's Discussion and Analysis

Medicaid rates are generally lower than rates earned from Medicare or private/other sources. Therefore, EHSI considers Quality Mix an important performance measurement indicator, where "Quality Mix" is defined as revenue or census earned from payor sources other than from Medicaid programs. In addition, within Quality Mix, EHSI focuses on short-term stay programs and services in its nursing home operations.

The following table sets forth EHSI's percentage of nursing facility revenue from continuing operations for each of its Medicare, private/other, and Medicaid payor sources, excluding prior period revenue settlement adjustments. Though the annual average Medicare census on a same-facility basis has declined in the past couple of years, the percentage of Medicare revenue has remained at similar levels due to an annual 3.1% increase in rates, an increase in the acuity care levels of Medicare patients served and changes to the RUGs classifications as of January 1, 2006.

| Revenue by Payor Source <i>(U.S. nursing facilities)</i> | First Quarter | | Second Quarter | | Third Quarter | | Fourth Quarter | |
|---|---------------|-------|----------------|-------|---------------|-------|----------------|-------|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2006 | 2005 |
| Medicare | 36.7% | 36.1% | 36.4% | 35.5% | 33.9% | 34.3% | 35.7% | 34.9% |
| Private/other | 16.7 | 16.1 | 16.8 | 16.5 | 17.2 | 16.3 | 16.1 | 15.7 |
| Quality Mix | 53.4 | 52.2 | 53.2 | 52.0 | 51.1 | 50.6 | 51.8 | 50.6 |
| Medicaid | 46.6 | 47.8 | 46.8 | 48.0 | 48.9 | 49.4 | 48.2 | 49.4 |

Medicare Funding

Effective January 1, 2006, CMS terminated the funding of the RUGs Refinement enhancements. In conjunction with this change, CMS expanded the 44 RUGs classifications to 53, providing nine new RUGs classifications to reimburse operators for the care provided for medically complex residents who require rehabilitation services and treatment of multiple illnesses. In addition, effective January 1, 2006, CMS also increased RUGs rates in the nursing and therapy components of the case mix index for all 53 RUGs rates. Despite the loss of the RUGs Refinements, EHSI's refocused marketing strategies successfully increased its average daily Medicare Part A rate by 7.1% to US\$372.32 for the 2006 year from US\$347.64 for the 2005 year. This increase included a 3.1% market basket increase effective October 1st in each of the years 2005 and 2006. Approximately 35.8% of EHSI's Medicare residents were classified within the nine new high acuity RUGs classifications during 2006, and the percentage of therapy residents increased from 78.5% in the 2005 year to 84.0% in the 2006 year. In the 2007 third quarter, EHSI's average Medicare Part A rate was US\$392.42, approximately 37.5% of its Medicare residents were classified within the nine new high acuity RUGs classifications and the percentage of therapy residents increased to 85.3%.

On October 1, 2007, CMS implemented a 3.3% market basket increase for Medicare rates. Based on the average rate for the 2007 third quarter, EHSI estimates this rate increase will result in a net improvement of approximately US\$12.95 in its average daily Medicare Part A rate. Based on EHSI's Medicare ADC for the first nine months of 2007, this would equate to additional annual revenue of approximately US\$11.4 million.

The U.S. Congress is currently reviewing CMS' October 1, 2007, market basket increase. While no changes to the increase are included in any bill currently before either house of Congress, changes have been proposed that could result in a reduction or elimination of the 3.3% increase. No final decision by either the House of Representatives or the Senate has yet been made, and it was not clear as of the date of this report when such a decision would be concluded.

Effective January 1, 2006, CMS implemented a cap on Part B therapy services of US\$1,740 per annum for physical and speech therapy, and a second cap of US\$1,740 per annum for occupational therapy. However, the Budget Refinement Act of 2005 established a one-year exception process to the therapy caps for individuals who can prove medical necessity for the therapy. The one-year exception process applies to approximately 35% of EHSI's residents requiring Part B therapy services and therefore, there has been no significant reduction in EHSI's Part B therapy revenue. Effective January 2007, the exception process was extended for an additional year. The Senate is expected to draft a new proposal to address the Part B therapy cap exemption.

The Medicare Part D benefit that arose from the Medicare Prescription Drug Improvement and Modernization Act of 2003 was implemented by CMS effective January 1, 2006, and provides access to prescription drug coverage for Medicare beneficiaries. Medicare Part D is a voluntary drug benefit, except for dually eligible Medicare and Medicaid residents, who must enrol in the program. The program provides a prescription drug benefit through a fee-for-service prescription drug plan, or PDP. For a premium, eligible residents have their drug costs administered through a government contracted PDP provider, who negotiates contracts with the institutional pharmacies, including Omnicare, Inc., or Omnicare, which provides pharmacy services to the majority of EHSI's nursing facilities. Omnicare has contracted with the majority of all PDPs to which EHSI's residents subscribe. To date, as a result of the transition plans put into place by CMS, EHSI has not

Management's Discussion and Analysis

experienced an increase in its drug costs as a result of these changes. However, EHSI could be faced with incremental drug and administrative costs as PDPs exercise their strategies to manage drug costs on behalf of their subscribers.

In November 2006 CMS issued federal regulations regarding procedures and documentation standards for skilled nursing facilities to be reimbursed for blood glucose monitoring. The new regulations require physicians to certify the necessity of each finger stick blood glucose test and document those orders effective January 1, 2007. The new rule will require such considerable effort on physicians and skilled nursing facilities that operators will no longer be able to bill for such procedures. EHSI estimates the loss of revenue from this new regulation was approximately US\$2.7 million during the first nine months of 2007 and is expected to be US\$3.6 million for the 2007 year.

Medicaid Rates

Each year on July 1, EHSI receives new annual Medicaid rates in seven of the eleven states in which it operates nursing facilities. The estimated increases in Medicaid rates as of July 1, 2007, excluding the impact of provider taxes and changes in case mix index (CMI) were: Pennsylvania – 0.4%, Ohio – 2.0%, Washington – 5.0%, Wisconsin – 1.1%, Kentucky – 4.5%, Oregon – 5.3% and Idaho – 10.8%. EHSI's estimated weighted average increase in Medicaid rates for its seven states with fiscal years beginning in 2007 is 2.5%, net of the impact of provider taxes and CMI changes, compared to 2.7% in 2006 and 1.4% in 2005. These estimates are subject to change based on future legislative and regulatory actions.

For the states with fiscal years beginning July 1, 2006, EHSI estimates that its weighted average Medicaid rate increase, excluding the impact of provider tax changes and case mix indices, was approximately 2.7%. In Washington EHSI's Medicaid rates increased by 9.9% effective July 1, 2006 as a result of the State updating to current operator costs. The annualized impact of the rate increase to EHSI is estimated at \$4.7 million (US\$4.2 million). In Ohio the State implemented a new reimbursement system, and EHSI's rates increased only 0.3% effective July 1, 2006. Pennsylvania also implemented a new reimbursement system effective July 1, 2006, and EHSI's estimated increase was 1.6%.

Effective January 1, 2006, the State of Indiana implemented a Medicaid rate reduction that amounted to approximately \$2.3 million (US\$2.1 million) per annum of lower revenue to EHSI, and applies to the 18-month period ended June 30, 2007. During this period the Medicaid rate will be adjusted for the impact of submitted cost reports and changes in case mix indices.

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

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

Update of Canadian Legislative Actions Affecting Revenue

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

Ontario Long-term Care Legislation

New legislation governing Ontario long-term care facilities, the Long-term Care Homes Act, 2007 (Bill 140) was given Royal Assent on June 4, 2007, although it will not be proclaimed into law until the regulations dealing with the specific aspects of the legislation are developed and approved. Bill 140 amalgamates three existing pieces of legislation currently governing long-term care facilities in the province: the Nursing Homes Act; the Homes for the Aged and Rest Homes Act; and the Charitable Institutions Act. Through consolidation, the government expects that Bill 140 will ensure uniform standards and accountability. Among other things, Bill 140 includes a new licensing process with defined terms for various classes of homes as follows: one year for "D" rated facilities that have not been upgraded; 10 years for upgraded "D" rated

Management's Discussion and Analysis

facilities; 15 years for "C" and "B" rated facilities; 20 years for "A" rated facilities; and 25 years for new homes. ECI has 11 new facilities in Ontario and the rest are "C" rated facilities. Bill 140 does not include a commitment to a capital renewal program for older buildings. However, on July 31, 2007, the government announced a redevelopment project to address this issue. The government announced that it will be redeveloping 35,000 older long-term care beds over the next 10 years, beginning in 2008 with 3,500 beds being redeveloped annually. ECI currently owns and operates approximately 3,572 older long-term care beds in 23 "C" rated facilities that would benefit from this redevelopment project. Details of the project have not as yet been provided. ECI and others continue to advocate appropriate changes and will work to provide input to the drafting of the regulations.

Ontario Long-term Care Funding

In February 2007 the Ontario government announced the annual acuity-based flow-through funding increase of 3.15% effective April 1, 2007 (compared to 1.98% in 2006), based on the provincial 2006 resident classification results. In addition to the April 1st annual acuity-based increases received in 2006 and 2007, the government provided additional funding targeted to providing more nurses in long-term care homes to help manage the rising cost of labour within the flow-through envelopes. ECI estimates that based on the number of long-term care beds it operates in Ontario, the April 1st flow-through funding increases received in 2006 and 2007 represent additional annual revenue of approximately \$4.4 million and \$6.0 million, respectively. These funding enhancements were provided to the flow-through envelopes and therefore, are offset by additional costs for resident care.

Effective July 1, 2007, the government provided an increase of \$0.11 per resident per day (or 2%) in funding for food costs and an increase of \$0.74 per resident per day (or 1.6%) in the per diem rate for the non flow-through accommodation envelope. ECI estimates that based on the number of long-term care beds it operates in Ontario, these funding enhancements represent additional annual revenue of approximately \$1.5 million, of which approximately \$0.2 million is directly allocated to food costs with the remainder available to assist in offsetting inflationary cost increases of accommodation.

Effective September 1, 2007, the Ontario government increased the daily food allowance for long-term care residents by 26% to \$7.00. Based on the number of residents served at September 30, 2007, this flow-through funding represents additional annual revenue to ECI of approximately \$2.6 million, and is required to be directed towards enhanced food costs.

Effective July 1, 2006, the government provided an increase of \$0.12 per resident per day (or 2.25%) in funding for food costs and an increase of \$0.78 per resident per day (or 1.76%) in the per diem rate for the non flow-through accommodation envelope. ECI estimates that based on the number of long-term care beds it operates in Ontario, these funding enhancements represent additional annual revenue of approximately \$1.6 million, of which approximately \$0.2 million is directly allocated to food costs with the remainder available to assist in offsetting inflationary cost increases of accommodation.

Alberta Long-term Care Funding

On April 1, 2007, the five Alberta health regions in which ECI operates provided annual inflationary rate increases, which for ECI, represented a weighted average increase of approximately 4.7%.

Effective October 1, 2007, the Alberta government increased the long-term care accommodation fee by approximately 5%, to meet rising costs. The province's last adjustment to accommodation fees occurred in 2003. For ECI, based on the long-term care beds operated in Alberta as of September 30, 2007, this funding improvement is expected to represent annual revenue of approximately \$0.9 million.

In March 2006 the Alberta government announced its 2006/2007 fiscal budget in which \$42.0 million was allocated to improve continuing care services. Changes included additional funding to enable increases in the number of hours of care per resident day to 3.6 hours, required to be implemented by January 2007. As a result, ECI does not anticipate a significant impact to earnings from these changes. An annual inflationary rate increase of 3.25% was received by long-term care providers effective April 1, 2006. As well, the July 1, 2006, annual funding adjustment for the case mix index was received, which varies by facility and can result in an increase or decrease in funding depending on the change in resident acuity levels. For ECI, the net impact of the July 2006 case mix index adjustments was minimal.

Management's Discussion and Analysis

Ontario Home Care 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 for the first nine months of 2007.

On May 1, 2006, the Ontario government announced funding of \$117.8 million to improve home care, of which \$30.0 million would be used to implement recommendations from a comprehensive review (the "Caplan Report") of the Community Care Access Centre Procurement Process. The announcement stated it was the intention of the government to implement 68 of 70 recommendations from the Caplan Report, which is intended to improve the procurement model with open and transparent practices, improve the quality and continuity of care, and support home care workforce stability. A Personal Support Worker Stabilization Strategy resulted in funding that was released in November 2006 on a retroactive basis to April 2006. ECI's portion for the period April 1, 2006 to March 31, 2007 was \$4.3 million. From April 1, 2007, this funding continues to be paid to providers separately until new contracts under the request for proposal (RFP) process are negotiated, at which time the funding will be embedded into the new contractual rates. Service providers will be required to report how the funds were spent. The majority of the funds received by ECI were allocated towards labour-related costs, such as compensation payments, enhanced travel and training programs and other employee benefits.

As well, as part of the Ontario government's strategy to reduce emergency room wait times, the government announced in October 2006, additional funding of \$30.0 million to support home care service volumes.

The home health care RFP process resumed in August 2007 under a revised template, prior to which, RFPs had been frozen since 2004 as a result of the study undertaken by the Ontario government and contracts that were due to expire were extended.

Regulatory Environment Affecting Operations

Extencicare operates in a competitive marketplace and depends 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 Extencicare. Extencicare also operates in a heavily regulated industry, subject to the scrutiny of federal, state and provincial regulators. Each of EHSI's and ECI's nursing homes must comply with regulations regarding staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental, biological and other standards. Government agencies have steadily increased their enforcement activity over the past several years. Management continually allocates increased resources to ensure compliance with and respond to, inspections, investigations and/or enforcement actions, and to improve the quality of services provided to Extencicare's residents.

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

On June 4, 2007, Extencicare REIT filed a Form 15F with the United States Securities and Exchange Commission (the "SEC") to voluntarily deregister its trust units under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Upon filing of the Form 15F, Extencicare REIT's obligation to file reports under sections 13(a) or 15(d) of the Exchange Act was immediately suspended and deregistration of the REIT Units became effective 90 days following the filing of the Form 15F with the SEC.

Summary of Quarterly Results

The following is a summary of selected consolidated financial information derived from unaudited interim period consolidated financial statements for each of the eight most recently completed quarters. Certain comparative figures have been reclassified for discontinued operations identified in 2007.

| <i>(thousands of dollars unless otherwise noted)</i> | First Quarter | | Second Quarter | | Third Quarter | | Fourth Quarter | |
|---|----------------|---------|----------------|----------|----------------|---------|----------------|---------|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2006 | 2005 |
| Revenue | 456,844 | 421,455 | 443,906 | 425,198 | 434,022 | 434,004 | 452,951 | 421,814 |
| EBITDA ⁽¹⁾ | 52,634 | 41,770 | 54,033 | 48,409 | 51,403 | 47,985 | 50,489 | 44,817 |
| Earnings from continuing health care operations before undernoted ⁽¹⁾ | 17,752 | 10,807 | 14,149 | 13,725 | 14,410 | 15,932 | 16,283 | 18,266 |
| Gain (loss) on derivative financial instruments and foreign exchange, net of taxes | 897 | 70 | 11,521 | 215 | 2,162 | (9,893) | (46,415) | 221 |
| Gain (loss) from restructuring charges, asset disposals and other items, net of taxes | – | (1,228) | 1,428 | (2,349) | – | (7,929) | (22,294) | 1,751 |
| Taxes associated with reorganization | – | – | – | (15,570) | – | – | – | – |
| Share of equity accounted earnings | 580 | 850 | 961 | 1,603 | – | 1,239 | 1,528 | 875 |
| Earnings (loss) from continuing operations | 19,229 | 10,499 | 28,059 | (2,376) | 16,572 | (651) | (50,898) | 21,113 |
| Discontinued operations, net of income taxes | (3,863) | 3,219 | 250 | 18 | (344) | 2,307 | 2,154 | 1,388 |
| Net earnings (loss) | 15,366 | 13,718 | 28,309 | (2,358) | 16,228 | 1,656 | (48,744) | 22,501 |
| Components of Diluted Earnings (Loss) per Unit/Share (\$) ⁽²⁾ | | | | | | | | |
| Continuing health care operations before undernoted | 0.25 | 0.15 | 0.20 | 0.20 | 0.21 | 0.23 | 0.23 | 0.26 |
| Gain (loss) on derivative financial instruments and foreign exchange | 0.01 | – | 0.17 | – | 0.02 | (0.14) | (0.67) | – |
| Gain (loss) from restructuring charges, asset disposals and other items | – | (0.01) | 0.02 | (0.04) | – | (0.12) | (0.32) | 0.03 |
| Taxes assoc. with reorganization | – | – | – | (0.23) | – | – | – | – |
| Share of equity accounted earnings | 0.01 | 0.01 | 0.01 | 0.03 | – | 0.02 | 0.02 | 0.01 |
| Earnings (loss) from continuing operations | 0.27 | 0.15 | 0.40 | (0.04) | 0.23 | (0.01) | (0.74) | 0.30 |
| Discontinued operations | (0.05) | 0.05 | – | – | – | 0.03 | 0.03 | 0.02 |
| Net earnings (loss) | 0.22 | 0.20 | 0.40 | (0.04) | 0.23 | 0.02 | (0.71) | 0.32 |

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

⁽²⁾ Diluted earnings per share calculations are prior to the Subordinate Voting Share preferential dividend.

Non-GAAP Measures

Extencicare REIT assesses and measures operating results and financial position based on performance measures referred to as "EBITDA", "continuing health care 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 "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 restructuring charges, asset disposals and other items". These line items are reported separately because they relate to the change in the fair value of, or gains and losses on termination of, interest rate lock, interest rate cap and foreign currency contracts, as well as gains or losses on the disposal or impairment of assets, provisions for restructuring charges, foreign exchange gains or losses on capital items, 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.

In addition, significant income tax items that did not relate to income earned in the current period are reported separately and have been identified as "taxes associated with reorganization". In the second quarter of 2006, an income tax provision was recorded with respect to the Reorganization and related primarily to withholding taxes on the cumulative undistributed share of earnings of EHSI.

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

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

Management's Discussion and Analysis

The following is a reconciliation of earnings (loss) from continuing health care operations before income taxes to EBITDA for each of the eight most recently completed quarters, and for the nine months ended September 2007 and 2006. Certain comparative figures have been reclassified for discontinued operations identified in 2007.

| <i>(thousands of dollars)</i> | First Quarter | | Second Quarter | | Third Quarter | | Fourth Quarter | |
|---|----------------|--------|-----------------|--------|----------------|---------|----------------|---------|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2006 | 2005 |
| Earnings (loss) from continuing health care operations before income taxes | 24,911 | 13,381 | 41,336 | 17,869 | 26,165 | (8,362) | (63,238) | 23,128 |
| Add (deduct): | | | | | | | | |
| Depreciation and amortization | 12,684 | 12,082 | 12,336 | 11,877 | 11,805 | 11,973 | 12,412 | 11,668 |
| Accretion expense | 341 | 320 | 331 | 315 | 317 | 314 | 314 | 329 |
| Interest expense, net | 16,195 | 14,169 | 17,779 | 14,900 | 16,541 | 14,678 | 13,718 | 12,244 |
| Loss (gain) on derivative financial instruments and foreign exchange | (1,497) | (103) | (15,557) | (359) | (3,425) | 16,627 | 50,585 | (351) |
| Loss (gain) from restructuring charges, asset disposals and other items | – | 1,921 | (2,192) | 3,807 | – | 12,755 | 36,698 | (2,201) |
| EBITDA | 52,634 | 41,770 | 54,033 | 48,409 | 51,403 | 47,985 | 50,489 | 44,817 |

| <i>(thousands of dollars)</i> | Nine months ended September | |
|--|-----------------------------|---------|
| | 2007 | 2006 |
| Earnings from continuing health care operations before income taxes | 92,412 | 22,888 |
| Add (deduct): | | |
| Depreciation and amortization | 36,825 | 35,932 |
| Accretion expense | 989 | 949 |
| Interest expense, net | 50,515 | 43,747 |
| Loss (gain) on derivative financial instruments and foreign exchange | (20,479) | 16,165 |
| Loss (gain) from restructuring charges, asset disposals and other items | (2,192) | 18,483 |
| EBITDA | 158,070 | 138,164 |

Impact of Foreign Currency Translation

The majority of Extencare's operations are conducted in the United States, which accounted for 68.5% of continuing revenue in the first nine months of 2007. 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 changes in the average exchange rates used in translating the U.S. results for the three and nine months ended September 30, 2007 and 2006, and its effect on the results for those periods in 2007, respectively.

| | Three months ended September | | Nine months ended September | |
|---|------------------------------|--------|-----------------------------|--------|
| | 2007 | 2006 | 2007 | 2006 |
| Average US/Canadian dollar exchange rate | 1.0477 | 1.1216 | 1.1055 | 1.1326 |
| Impact on Periods ended September 2007 (millions of dollars) | | | | |
| Revenue | (20.7) | | (22.4) | |
| EBITDA | (2.7) | | (2.9) | |
| Net earnings | (0.8) | | (1.1) | |

2007 Third Quarter Results

| <i>(thousands of dollars unless otherwise noted)</i> | Q3 2007 | Q3 2006 | <i>Change Q3/07 over Q3/06</i> | Q2 2007 | <i>Change Q3/07 over Q2/07</i> |
|---|--------------------|--------------------|--|--------------------|--|
| Earnings (Loss) from Continuing Health Care Operations | | | | | |
| U.S. operations in its functional currency (US\$) | 11,693 | 26 | 11,667 | 17,312 | (5,619) |
| Translation to Canadian dollars | 409 | (332) | | 1,749 | |
| U.S. operations (C\$) | 12,102 | (306) | 12,408 | 19,061 | (6,959) |
| Canadian operations | 4,470 | (1,584) | 6,054 | 8,037 | (3,567) |
| | 16,572 | (1,890) | 18,462 | 27,098 | (10,526) |
| Share of equity accounted earnings | – | 1,239 | (1,239) | 961 | (961) |
| Earnings (loss) from continuing operations | 16,572 | (651) | 17,223 | 28,059 | (11,487) |
| Discontinued operations | (344) | 2,307 | (2,651) | 250 | (594) |
| Net earnings | 16,228 | 1,656 | 14,572 | 28,309 | (12,081) |
| Diluted Earnings (Loss) per Unit/Subordinate Voting Share (\$) | | | | | |
| Earnings (loss) from continuing operations | 0.23 | (0.01) | | 0.40 | |
| Net earnings | 0.23 | 0.02 | | 0.40 | |
| Earnings (Loss) from Continuing Health Care Operations before Undernoted | | | | | |
| U.S. operations in its functional currency (US\$) | 9,357 | 10,329 | (972) | 10,597 | (1,240) |
| U.S. operations (C\$) | 9,696 | 11,195 | (1,499) | 11,604 | (1,908) |
| Canadian operations | 4,714 | 4,737 | (23) | 2,545 | 2,169 |
| Earnings (loss) from continuing health care operations before undernoted | 14,410 | 15,932 | (1,522) | 14,149 | 261 |
| Gain on derivative financial instruments and foreign exchange, net of taxes | 2,162 | (9,893) | 12,055 | 11,521 | (9,359) |
| Gain (loss) from restructuring charges, asset disposals and other items, net of taxes | – | (7,929) | 7,929 | 1,428 | (1,428) |
| Earnings (loss) from continuing health care operations | 16,572 | (1,890) | 18,462 | 27,098 | (10,526) |
| Average US/Canadian dollar exchange rate | 1.0477 | 1.1216 | | 1.0986 | |

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were: 1.0477 for the 2007 third quarter, 1.1216 for the 2006 third quarter and 1.0986 for the 2007 second quarter. Net earnings for the 2007 third quarter were negatively impacted by \$0.8 million as a result of applying the lower 2007 average foreign exchange rate versus the 2006 rate on translation of the U.S. operations.

Earnings from continuing health care operations prior to separately reported items, as noted in the table above, were \$14.4 million (\$0.21 per diluted unit) in the 2007 third quarter compared to \$15.9 million (\$0.23 per diluted share) in the 2006 third quarter. Separately reported items in the 2007 third quarter related to the valuation of derivative financial instruments and foreign exchange gains on capital items of \$2.2 million after-tax (\$0.02 per diluted unit). Such items in the 2006 third quarter were an after-tax loss of \$9.9 million (\$0.14 loss per diluted share) on the valuation of derivative financial instruments and an after-tax loss of \$7.9 million (\$0.12 loss per diluted share) related primarily to the Reorganization. The share of equity accounted earnings from Crown Life was nil in the 2007 third quarter due to its sale in July 2007, compared to \$1.2 million in the 2006 third quarter. Earnings from continuing operations, including separately reported items and equity accounted earnings, were \$16.6 million (\$0.23 per diluted unit) compared to a loss of \$0.7 million (\$0.01 loss per diluted Subordinate Voting Share) in the 2006 third quarter.

Management's Discussion and Analysis

Earnings from continuing U.S. operations were \$12.1 million compared to a loss of \$0.3 million in the 2006 third quarter. Excluding separately reported after-tax gains of \$2.4 million in the 2007 third quarter, and a loss of \$11.5 million in the 2006 third quarter, earnings from U.S. operations were \$9.7 million and \$11.2 million, respectively, reflecting a decline of \$1.5 million. However, excluding future income tax credits recorded in the 2006 third quarter of \$3.1 million and a \$0.4 million negative impact from the stronger Canadian dollar, earnings from U.S. operations increased \$2.0 million, reflecting operational improvements over the 2006 third quarter. EBITDA from the U.S. operations, excluding a \$2.7 million negative impact from the stronger Canadian dollar, improved between periods by \$4.2 million, due to funding improvements, higher Medicare patient acuity mix and acquisitions, partially offset by lower occupancy levels. Net financing costs of the U.S. operations were relatively unchanged, with increases in external financing costs of \$1.7 million due to higher debt levels resulting from the Reorganization, acquisitions and growth capital expenditures, partially offset by an increase in intercompany interest income of \$0.8 million, and a favourable \$0.8 million impact from the stronger Canadian dollar.

Earnings from continuing Canadian operations were \$4.5 million in the 2007 third quarter compared to a loss of \$1.6 million in the 2006 third quarter. Earnings for both periods were \$4.7 million, excluding a separately reported after-tax foreign exchange loss of \$0.2 million in the 2007 third quarter, and an after-tax loss from restructuring charges and other items of \$6.3 million in the 2006 third quarter. EBITDA from the Canadian operations improved between periods by \$1.9 million due to lower general and administrative costs of \$1.1 million and improvements in operations. However, net financing costs increased by \$1.8 million, due to \$2.3 million of interest on additional debt and \$0.8 million from intercompany borrowings, partially offset by \$1.3 million of income from cash and investments.

Discontinued operations reported a loss of \$0.3 million in the 2007 third quarter compared to earnings of \$2.3 million in the 2006 third quarter. The 2006 third quarter included the earnings of ALC that were distributed to shareholders as part of the 2006 Reorganization. Further details of the components of the results of the discontinued operations are provided in *note 5* of the unaudited consolidated financial statements for the nine months ended September 30, 2007.

Earnings from continuing health care operations in comparison to the 2007 second quarter declined by \$10.5 million to \$16.6 million from \$27.1 million. The 2007 third quarter results included a separately reported after-tax gain of \$2.2 million from derivative financial instruments and foreign exchange. The 2007 second quarter results included separately reported after-tax gains of \$11.5 million from derivative financial instruments and foreign exchange, and \$1.4 million on the disposal of non-core assets. Prior to these items, earnings from continuing health care operations were relatively unchanged at \$14.4 million in the 2007 third quarter compared to earnings of \$14.1 million in the 2007 second quarter, of which the stronger Canadian dollar had a negative \$0.5 million impact on earnings. However, the 2007 second quarter results included an additional amount for SIFT tax of \$1.1 million (see "Significant Developments – Canadian Federal Income Tax on Income Trusts"). EBITDA declined \$2.6 million to \$51.4 million in the 2007 third quarter from \$54.0 million in the 2007 second quarter, of which \$1.9 million was due to the impact of the stronger Canadian dollar. Improvements from Canadian operations, mainly reflecting higher revenue and lower utility costs, were offset by lower occupancy from U.S. operations due to lower volumes of elective surgeries and other hospital procedures during the summer months.

Revenue

Revenue from continuing operations was \$434.0 million in each of the third quarters of 2007 and 2006. Newly acquired facilities generated revenue of \$14.1 million in the 2007 third quarter and \$10.8 million in the 2006 third quarter, for a favourable improvement of \$3.3 million. Revenue from same-facility operations was \$419.9 million compared to \$423.2 million and included a negative impact from the stronger Canadian dollar of \$19.6 million. Revenue from same-facility operations, excluding the impact of foreign exchange, improved \$16.3 million, or 3.9%, due to funding improvements and higher Medicare patient acuity mix, partially offset by lower occupancy.

| <i>(millions of dollars unless otherwise noted)</i> | Q3 2007 | Q3 2006 | <i>Change Q3/07 over Q3/06</i> | <i>Change (%)</i> | Q2 2007 | <i>Change Q3/07 over Q2/07</i> |
|---|--------------------|--------------------|--|-----------------------|--------------------|--|
| Revenue | | | | | | |
| U.S. operations in its functional currency (US\$) | 278.4 | 264.2 | 14.2 | 5.4 | 275.4 | 3.0 |
| Translation to Canadian dollars | 13.2 | 32.2 | | | 27.1 | |
| U.S. operations (C\$) | 291.6 | 296.4 | (4.8) | (1.6) | 302.5 | (10.9) |
| Canadian operations | 142.4 | 137.6 | 4.8 | 3.5 | 141.4 | 1.0 |
| | 434.0 | 434.0 | – | – | 443.9 | (9.9) |

Management's Discussion and Analysis

Revenue from U.S. operations grew 5.4% in its functional currency to US\$278.4 million in the 2007 third quarter compared to US\$264.2 million in the 2006 third quarter, representing an increase of US\$14.2 million, of which US\$3.9 million resulted from acquisitions. New facilities acquired related to a skilled nursing home and an assisted living facility purchased during 2007 and four skilled nursing homes acquired in 2006 (see "Significant Developments – Acquisitions Completed and Pending"). Revenue on a same-facility basis increased by US\$10.3 million or 4.1%.

The following table provides further details on the change in revenue from same-facility U.S. operations.

(US\$ millions)

| | |
|-------|---|
| 12.2 | – increase in average nursing home rates (Medicare \$4.5 million, Medicaid \$4.8 million, and private/other \$2.9 million) |
| (3.7) | – increase (decrease) in nursing home resident census (Medicare \$(3.4) million, Medicaid \$(0.9) million, and private/other \$0.6 million) |
| 1.1 | – increase in nursing home resident ancillary services, primarily therapy and rehabilitative services |
| 0.9 | – other revenue |
| 10.5 | |
| (0.2) | – lower prior period revenue adjustments (none in 2007 compared to \$0.2 million in 2006 third quarter) |
| 10.3 | |

Key Medicare and Medicaid statistics for the U.S. nursing home operations are summarized in the following table.

| U.S. Nursing Home Operating Statistics | Q3 2007 | Q3 2006 | Change Q3/07 over Q3/06 % | Q2 2007 | Change Q3/07 over Q2/07 (%) |
|---|------------|------------|---------------------------------|------------|-----------------------------------|
| Average daily census (same-facility basis) | | | | | |
| Medicare | 2,129 | 2,230 | (4.5) | 2,347 | (9.3) |
| Private/other | 1,988 | 1,957 | 1.6 | 1,936 | 2.7 |
| Medicaid | 8,289 | 8,350 | (0.7) | 8,170 | 1.5 |
| Total | 12,406 | 12,537 | (1.0) | 12,453 | (0.4) |
| Medicare as a percent of total census (same-facility basis) | 17.2 | 17.8 | | 18.9 | |
| Medicaid as a percent of total census (same-facility basis) | 66.8 | 66.6 | | 65.6 | |
| Average percentage occupancy (same-facility basis) | 90.0 | 91.1 | | 90.3 | |
| Average revenue rate by payor source (US\$) ⁽¹⁾ | | | | | |
| Medicare Part A and B | 434.21 | 406.04 | 6.9 | 423.62 | 2.5 |
| Private/other | 239.64 | 221.35 | 8.3 | 239.18 | 0.2 |
| Medicaid | 162.70 | 156.43 | 4.0 | 158.38 | 2.7 |
| Medicare Part A | 392.42 | 369.12 | 6.3 | 388.93 | 0.9 |

⁽¹⁾ From continuing operations, excluding prior period settlement adjustments.

EHSI's average daily Medicare Part A rate increased 6.3% to US\$392.42 in the 2007 third quarter from US\$369.12 in the 2006 third quarter. CMS's annual inflationary rate increase was 3.1% effective October 1, 2006 and the balance of the improvement was attributable to the increase in the acuity care levels of Medicare patients served. For further details, refer to "Significant Developments – Medicare Funding".

Excluding the impact of prior period Medicaid settlement adjustments, EHSI's average Medicaid rate increased 4.0% from the 2006 third quarter. For a number of states, the increase in average Medicaid revenue per resident day was primarily attributable to increases in acuity of care levels and funding for additional state assessment fees and taxes.

Revenue from Canadian operations grew \$4.8 million, or 3.5%, to \$142.4 million in the 2007 third quarter from \$137.6 million in the 2006 third quarter. Nursing home operations contributed \$3.8 million to the improvement, resulting from funding to enhance resident care. Home health care revenue improved by \$0.7 million due primarily to funding enhancements, partially offset by lower volumes. Other revenue increased by \$0.3 million.

EBITDA

Operating, administrative and lease costs from continuing operations were \$382.6 million in the 2007 third quarter compared to \$386.0 million in the 2006 third quarter. Newly acquired facilities increased these costs by \$2.5 million between periods. Operating, administrative and lease costs from same-facility operations were \$371.0 million in the 2007 third quarter compared to \$376.9 million in the 2006 third quarter. Excluding a \$17.1 million favourable impact from a stronger Canadian dollar, these costs on a same-facility basis increased \$11.2 million, of which labour-related costs accounted for \$7.6 million of the increase.

Labour-related costs from continuing operations represented 74.4% of operating and administrative costs in the 2007 third quarter compared to 74.5% in the 2006 third quarter, and as a percent of revenue, were 65.0% and 65.7%, respectively.

EBITDA from same-facility operations was \$48.8 million in the 2007 third quarter compared to \$46.2 million in the 2006 third quarter. Excluding a \$2.5 million negative impact of a stronger Canadian dollar, same-facility EBITDA improved by \$5.1 million, or 11.0%, based on improvements in revenue of \$16.3 million partially offset by higher operating, administrative and lease costs of \$11.2 million. As a percent of revenue, EBITDA from same-facility operations improved to 11.6% from 10.9% in the 2006 third quarter due to funding improvements, higher Medicare patient acuity mix, partially offset by lower U.S. occupancy levels.

| <i>(millions of dollars unless otherwise noted)</i> | Q3 | <i>% of</i> | Q3 | <i>% of</i> | <i>Change</i> | <i>Change</i> | Q2 | <i>Change</i> |
|---|---------------|----------------|-------------|----------------|---------------|---------------|-------------|---------------|
| | 2007 | <i>revenue</i> | 2006 | <i>revenue</i> | <i>Q3/07</i> | <i>(%)</i> | 2007 | <i>Q3/07</i> |
| | | | | | <i>over</i> | | | <i>over</i> |
| | | | | | <i>Q3/06</i> | | | <i>Q2/07</i> |
| EBITDA | | | | | | | | |
| U.S. operations in its functional currency (US\$) | 34.6 | <i>12.4</i> | 30.9 | <i>11.7</i> | 3.7 | <i>12.0</i> | 36.1 | (1.5) |
| Translation to Canadian dollars | 1.6 | | 3.8 | | | | 3.5 | |
| U.S. operations (C\$) | 36.2 | <i>12.4</i> | 34.7 | <i>11.7</i> | 1.5 | <i>4.3</i> | 39.6 | (3.4) |
| Canadian operations | 15.2 | <i>10.7</i> | 13.3 | <i>9.7</i> | 1.9 | <i>14.3</i> | 14.4 | 0.8 |
| | 51.4 | <i>11.8</i> | 48.0 | <i>11.1</i> | 3.4 | <i>7.1</i> | 54.0 | (2.6) |
| Average US/Canadian dollar exchange rate | 1.0477 | | 1.1216 | | | | 1.0986 | |

EBITDA from U.S. operations improved US\$3.7 million to US\$34.6 million in the 2007 third quarter from US\$30.9 million in the 2006 third quarter, and as a percent of revenue was 12.4% compared to 11.7% in the 2006 third quarter. Excluding an improvement between periods of US\$0.9 million attributable to acquisitions, EBITDA from same-facility operations was US\$32.1 million in the 2007 third quarter compared to US\$29.3 million in the 2006 third quarter, representing an increase of US\$2.8 million. Improvements in revenue from same-facility operations of US\$10.3 million, discussed above, more than offset higher operating, administrative and lease costs of US\$7.5 million, as detailed in the table below.

(US\$ millions)

| | |
|------------|---|
| 4.7 | – rise in labour-related costs of 3.0%, which included an average wage rate increase of 3.9% in nursing home operations |
| 0.9 | – increase in food, medical equipment, and supplies |
| 0.6 | – increase in provision for bad debts |
| 0.3 | – increase in utilities, telephone and travel costs |
| 1.0 | – increase in other costs |
| 7.5 | |

Labour-related cost increases were primarily driven by enhancements offered to attract and/or retain therapists, as part of management's strategy to focus on Medicare rehabilitative residents. Labour costs for the U.S. operations in each of the third quarters of 2007 and 2006 represented 70.1% and 70.5% of operating and administrative costs, and represented 60.9% and 61.7% of revenue, respectively. General and administrative costs for the U.S. operations were US\$10.2 million in the third quarter of 2007 compared to US\$9.3 million in the third quarter of 2006.

Management's Discussion and Analysis

EBITDA from Canadian operations was \$15.2 million in the 2007 third quarter compared to \$13.3 million in the 2006 third quarter, representing an improvement of \$1.9 million. Revenue improvements of \$4.8 million and lower administrative costs of \$1.1 million were only partially offset by higher operating and lease costs of \$4.0 million. General and administrative costs of the Canadian operations declined to \$5.0 million in the 2007 third quarter from \$6.1 million in the 2006 third quarter, as a result of lower salaries and benefits primarily due to the Reorganization.

Depreciation, Amortization and Accretion

Depreciation, amortization and accretion costs, excluding a favourable impact of \$0.6 million due to the stronger Canadian dollar, were higher by \$0.5 million in the 2007 third quarter from the 2006 third quarter primarily due to acquisitions and construction.

Interest

Interest expense, net of interest income, increased \$1.9 million in the 2007 third quarter from the 2006 third quarter. Excluding a favourable impact of \$0.8 million from the stronger Canadian dollar, net interest costs increased \$2.7 million between periods due to higher debt levels associated with the Reorganization, acquisitions and construction, partially offset by higher interest income from cash and short-term investments.

Income Taxes

The tax provision from continuing operations was \$9.6 million in the 2007 third quarter compared to a tax recovery of \$6.5 million in the 2006 third quarter. The effective tax rate for the 2007 third quarter was 36.7% compared to 77.4% in the 2006 third quarter, both of which were distorted by gains and losses from derivative financial instruments, foreign exchange, restructuring charges, asset disposals and other items. Excluding these items, the effective tax rate for the 2007 third quarter was 36.6% compared to 24.2% in the 2006 third quarter. In addition, the 2006 third quarter tax provision included future income tax credits related to the expiration of certain statutes of limitations of U.S. tax liabilities of \$3.1 million. Excluding these items the effective tax rate for the 2006 third quarter would have been 39.2%.

The tax provision included a provision for SIFT tax of \$1.2 million for the 2007 third quarter. The provision represents management's estimate based on its understanding of the SIFT Rules and the REIT's current structure. For further information on this, refer to the discussion under "Significant Developments – Canadian Federal Income Tax on Income Trusts".

Share of Equity Accounted Earnings

The share of equity accounted earnings was nil in the 2007 third quarter compared to \$1.2 million in the 2006 third quarter. On July 5, 2007, Extencare finalized the sale of its investment in Crown Life. For further information, refer to "Significant Developments – Investment in Crown Life Insurance Company".

2007 Nine Month Results

| <i>(thousands of dollars unless otherwise noted)</i> | Nine months ended September | | |
|---|--------------------------------|----------|---------|
| | 2007 | 2006 | Change |
| Earnings from Continuing Health Care Operations | | | |
| U.S. operations in its functional currency (US\$) | 42,621 | 3,473 | 39,148 |
| Translation to Canadian dollars | 4,464 | 140 | |
| U.S. operations (C\$) | 47,085 | 3,613 | 43,472 |
| Canadian operations | 15,234 | 167 | 15,067 |
| | 62,319 | 3,780 | 58,539 |
| Share of equity accounted earnings | 1,541 | 3,692 | (2,151) |
| Earnings from continuing operations | 63,860 | 7,472 | 56,388 |
| Discontinued operations | (3,957) | 5,544 | (9,501) |
| Net earnings | 59,903 | 13,016 | 46,887 |
| Diluted Earnings per Unit/Subordinate Voting Share (\$) | | | |
| Earnings from continuing operations | 0.90 | 0.11 | |
| Net earnings | 0.85 | 0.19 | |
| Earnings from Continuing Health Care Operations before Undernoted | | | |
| U.S. operations in its functional currency (US\$) | 32,799 | 27,251 | 5,548 |
| U.S. operations (C\$) | 36,325 | 30,455 | 5,870 |
| Canadian operations | 9,986 | 10,009 | (23) |
| Earnings from continuing health care operations before undernoted | 46,311 | 40,464 | 5,847 |
| Gain (loss) on derivative financial instruments and foreign exchange, net of taxes | 14,580 | (9,608) | 24,188 |
| Gain (loss) from restructuring charges, asset disposals and other items, net of taxes | 1,428 | (27,076) | 28,504 |
| Earnings from continuing health care operations | 62,319 | 3,780 | 58,539 |
| Average US/Canadian dollar exchange rate | 1.1055 | 1.1326 | |

⁽¹⁾ Does not add due to rounding.

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were: 1.1055 for the first nine months of 2007 and 1.1326 for the first nine months of 2006. Net earnings for the first nine months of 2007 were negatively impacted by \$1.1 million as a result of applying the lower 2007 average foreign exchange rate versus the 2006 rate on translation of the U.S. operations.

Earnings from continuing health care operations prior to separately reported items, as indicated in the table above, were \$46.3 million (\$0.66 per diluted unit) in the first nine months of 2007 compared to \$40.5 million (\$0.58 per diluted share) in the first nine months of 2006, representing an improvement of \$5.8 million. Separately reported items in the first nine months of 2007, included after-tax gains related to the valuation of derivative financial instruments and foreign exchange of \$14.6 million after-tax (\$0.20 per diluted unit), and an after-tax gain of \$1.4 million (\$0.02 per diluted unit) on the disposal of non-core assets. Such items in the first nine months of 2006 were an after-tax loss of \$9.6 million (\$0.14 loss per diluted share) on the valuation of derivative financial instruments and an after-tax loss of \$27.1 million (\$0.40 loss per diluted share) related primarily to the Reorganization. The REIT's share of equity accounted earnings was \$1.5 million in the first nine months of 2007 compared to \$3.7 million in the first nine months of 2006. Earnings from continuing operations, including separately reported items and equity accounted earnings, were \$63.9 million (\$0.90 per diluted unit) compared to \$7.5 million (\$0.11 per diluted Subordinate Voting Share) in the first nine months of 2006.

Earnings from continuing U.S. operations for the first nine months of 2007 were \$47.1 million compared to \$3.6 million in the first nine months of 2006. Excluding separately reported after-tax gains of \$10.8 million in the first nine months of 2007 and a loss of \$26.8 million in the first nine months of 2006, earnings from U.S. operations were \$36.3 million and \$30.4 million, respectively. The improvement of \$5.9 million between periods resulted primarily from nursing home funding increases and newly acquired facilities, partially offset by future income tax credits of \$4.2 million recorded in 2006 and lower occupancy levels. Net financing costs of the U.S. operations were relatively unchanged, with increases in external financing costs of \$6.6 million due to higher debt levels resulting from the Reorganization, acquisitions and growth capital expenditures, offset by an increase in intercompany interest income of \$5.9 million with the Canadian operations, and a favourable \$0.9 million impact from the stronger Canadian dollar.

Management's Discussion and Analysis

Earnings from continuing Canadian operations were \$15.2 million in the first nine months ended of 2007 compared to \$0.2 million in the first nine months of 2006. The 2007 results included a separately reported after-tax foreign exchange gain of \$5.2 million compared to a loss of \$9.8 million for restructuring charges and other items in the first nine months of 2006. Excluding these items, earnings were \$10.0 million in both periods. Earnings from the core nursing home operations improved between periods due to funding improvements, which were partially offset by higher operating costs. General and administrative costs in the first nine months of 2007 declined to \$14.6 million from \$19.9 million in the first nine months of 2006, as a result of lower salaries and benefits primarily due to the Reorganization, of which share-based compensation costs accounted for \$2.2 million. Net interest costs were higher by \$6.9 million, of which \$5.9 million related to intercompany borrowings from the U.S. operations.

Discontinued operations reported a loss of \$4.0 million in the first nine months of 2007 compared to earnings of \$5.5 million in the first nine months of 2006. The 2006 results included the earnings of ALC that were distributed to shareholders in November 2006. Discontinued operations for the first nine months of 2007 included a pre-tax impairment charge of \$6.0 million related to an Ohio nursing home that EHESI voluntarily closed due to poor performance. Further details of the components of the results of the discontinued operations are provided in *note 5* of the unaudited consolidated financial statements for the nine months ended September 30, 2007.

Revenue

Revenue from continuing operations improved \$54.1 million to \$1,334.8 million in the first nine months of 2007 from \$1,280.7 million in the first nine months of 2006. Newly acquired facilities generated revenue of \$41.3 million in the first nine months of 2007 and \$21.9 million in the first nine months of 2006, for a favourable improvement of \$19.4 million. Revenue from same-facility operations increased \$34.7 million, and was unfavourably impacted by \$21.4 million due to a stronger Canadian dollar. Excluding the foreign exchange impact, revenue improved between periods by \$56.1 million, or 4.5%, due to funding improvements and a more favourable patient acuity mix, partially offset by lower U.S. occupancy levels.

| <i>(millions of dollars unless otherwise noted)</i> | Nine months ended September | | | |
|---|--|-------------|---------------|-------------------|
| | 2007 | 2006 | <i>Change</i> | <i>Change (%)</i> |
| Revenue | | | | |
| U.S. operations in its functional currency (US\$) | 826.7 | 773.4 | 53.3 | 6.9 |
| Translation to Canadian dollars | 87.2 | 102.6 | | |
| U.S. operations (C\$) | 913.9 | 876.0 | 37.9 | 4.3 |
| Canadian operations | 420.9 | 404.7 | 16.2 | 4.0 |
| | 1,334.8 | 1,280.7 | 54.1 | 4.2 |

Revenue from U.S. operations grew 6.9% in its functional currency to US\$826.7 million in the first nine months of 2007 compared to US\$773.4 million in the first nine months of 2006, representing an increase of US\$53.3 million, of which US\$18.0 million resulted from acquisitions. New facilities acquired related to a skilled nursing home and an assisted living facility purchased during 2007 and four skilled nursing homes acquired in 2006 (see "Significant Developments – Acquisitions Completed and Pending"). Revenue from same-facility operations increased by US\$35.2 million or 4.7%.

The following table provides further details on the change in revenue from same-facility U.S. operations.

| <i>(US\$ millions)</i> | |
|------------------------|--|
| 37.5 | – increase in average nursing home rates (Medicare \$13.5 million, Medicaid \$14.2 million, and private/other \$9.8 million) |
| (6.8) | – decrease in nursing home resident census (Medicare \$(1.6) million, Medicaid \$(4.8) million, and private/other \$(0.4) million) |
| 2.9 | – increase in nursing home resident ancillary services, primarily therapy and rehabilitative services |
| 3.4 | – other revenue |
| 37.0 | |
| (1.8) | – lower prior period revenue adjustments (\$0.2 million in 2007 compared to \$2.0 million in 2006) |
| 35.2 | |

Management's Discussion and Analysis

Key Medicare and Medicaid statistics for the U.S. nursing home operations are summarized in the following table.

| U.S. Nursing Home Operating Statistics | Nine months ended September | | |
|---|-----------------------------|--------|------------|
| | 2007 | 2006 | Change (%) |
| Average daily census (same-facility basis) | | | |
| Medicare | 2,284 | 2,300 | (0.7) |
| Private/other | 1,957 | 1,966 | (0.5) |
| Medicaid | 8,217 | 8,332 | (1.4) |
| Total | 12,458 | 12,598 | (1.1) |
| Medicare as a percent of total census (same-facility basis) | 18.3 | 18.3 | |
| Medicaid as a percent of total census (same-facility basis) | 66.0 | 66.1 | |
| Average percentage occupancy (same-facility basis) | 90.4 | 91.7 | |
| Average revenue rate by payor source (US\$) ⁽¹⁾ | | | |
| Medicare Part A and B | 427.10 | 402.92 | 6.0 |
| Private/other | 239.38 | 219.25 | 9.2 |
| Medicaid | 159.63 | 152.82 | 4.5 |
| Medicare Part A | 389.69 | 368.74 | 5.7 |

⁽¹⁾ From continuing operations, excluding prior period settlement adjustments.

EHSI's average daily Medicare Part A rate increased 5.7% to US\$389.69 in the first nine months of 2007 from US\$368.74 in the first nine months of 2006. CMS's annual inflationary rate increase was 3.1% effective October 1, 2006 and the balance of the improvement was attributable to the increase in the acuity care levels of Medicare patients served. For further details, refer to "Significant Developments – Medicare Funding".

Excluding the impact of the prior period Medicaid settlement adjustments, EHSI's average Medicaid rate for the first nine months of 2007 increased by 4.5% from the first nine months of 2006. For a number of states, the increase in average Medicaid revenue per resident day was primarily attributable to increases in acuity of care levels and funding for increased state assessment fees and taxes. Without these items, the average Medicaid revenue per resident day increased approximately 3.5%.

Revenue from Canadian operations grew \$16.2 million, or 4.0%, to \$420.9 million in the first nine months of 2007 from \$404.7 million in the first nine months of 2006. Of this improvement, \$13.1 million was derived from nursing home operations, and represented funding to enhance resident care. Revenue from home health care operations increased \$2.1 million, or 2.0%, due primarily to funding enhancements, partially offset by lower volumes. Other revenue increased by \$1.0 million.

EBITDA

Operating, administrative and lease costs from continuing operations increased \$34.2 million to \$1,176.7 million in the first nine months of 2007 from \$1,142.5 million in the first nine months of 2006. Newly acquired facilities contributed \$15.4 million to the increase. Operating, administrative and lease costs from same-facility operations were \$1,142.3 million in the first nine months of 2007 compared to \$1,123.4 million in the first nine months of 2006, representing an increase of \$18.9 million. Had it not been for an \$18.7 million favourable impact from a stronger Canadian dollar, these costs on a same-facility basis would have been \$37.5 million higher, of which labour-related costs accounted for \$26.5 million of the increase.

Labour-related costs from continuing operations represented 74.1% of operating and administrative costs in the first nine months of 2007 compared to 74.4% in the first nine months of 2006, and as a percent of revenue, were 64.8% and 65.8%, respectively. General and administrative costs totalled \$48.6 million in the first nine months of 2007 compared to \$52.8 million in the first nine months of 2006, reflecting a decline of \$4.2 million, of which \$3.1 million was due to share-based compensation costs recorded in 2006, and \$0.8 million was due to the impact of the stronger Canadian dollar.

Management's Discussion and Analysis

EBITDA from same-facility operations was \$151.2 million in the first nine months of 2007, up \$15.9 million from \$135.3 million in the first nine months of 2006. Excluding a \$2.7 million negative impact of a stronger Canadian dollar, EBITDA improved by \$18.6 million, or 13.7%, reflecting improvements in revenue of \$56.1 million and lower administrative costs of \$3.4 million, partially offset by higher operating and lease costs of \$40.9 million. As a percent of revenue, EBITDA from same-facility operations improved to 11.7% from 10.8% in the first nine months of 2006 due to funding improvements, changes in Medicare patient mix, and lower share-based compensation costs, partially offset by lower U.S. occupancy levels.

| <i>(millions of dollars unless otherwise noted)</i> | Nine months ended September | | | | | |
|---|-----------------------------|--------------|--------|--------------|--------|------------|
| | 2007 | % of revenue | 2006 | % of revenue | Change | Change (%) |
| EBITDA | | | | | | |
| U.S. operations in its functional currency (US\$) | 106.4 | 12.9 | 92.5 | 12.0 | 13.9 | 15.0 |
| Translation to Canadian dollars | 11.2 | | 12.3 | | | |
| U.S. operations (C\$) | 117.6 | 12.9 | 104.8 | 12.0 | 12.8 | 12.2 |
| Canadian operations | 40.5 | 9.6 | 33.4 | 8.3 | 7.1 | 21.3 |
| | 158.1 | 11.8 | 138.2 | 10.8 | 19.9 | 14.4 |
| Average US/Canadian dollar exchange rate | 1.1055 | | 1.1326 | | | |

EBITDA from U.S. operations improved US\$13.9 million to US\$106.4 million in the first nine months of 2007 from US\$92.5 million in the first nine months of 2006, and as a percent of revenue improved to 12.9% from 12.0%, respectively. Acquisitions contributed US\$3.8 million to the improvement to EBITDA between periods. EBITDA from same-facility operations was US\$100.1 million in the first nine months of 2007 compared to US\$90.0 million in the first nine months of 2006, representing an improvement of US\$10.1 million, despite lower prior period settlement adjustments of US\$1.8 million. Improvements in revenue from same-facility operations of US\$35.2 million, discussed previously, more than offset higher operating, administrative and lease costs of US\$25.1 million, as detailed in the table below.

(US\$ millions)

| | |
|-------------|---|
| 18.4 | – rise in labour-related costs of 4.0%, which included an average wage rate increase of 4.6% in nursing home operations |
| 2.3 | – increase in provision for bad debts |
| 2.9 | – increase in food, medical equipment, and supplies |
| 1.5 | – increase in drug costs |
| 1.4 | – increase in utilities, telephone and travel costs |
| (3.1) | – decrease in professional fees, fines and penalties |
| 1.7 | – increase in other costs |
| 25.1 | |

Labour-related cost increases were primarily driven by enhancements offered to attract and/or retain therapists, as part of management's strategy to focus on Medicare rehabilitative residents. As a percent of operating and administrative costs, labour costs for the U.S. operations represented 70.2% in the first nine months of 2007 compared to 70.4% in the first nine months of 2006. As a percent of revenue, labour costs for the U.S. operations represented 60.7% in the first nine months of 2007 and 61.4% in the first nine months of 2006. General and administrative costs for the U.S. operations were US\$30.7 million in the first nine months of 2007 compared to US\$29.1 million in the first nine months of 2006.

EBITDA from Canadian operations was \$40.5 million in the first nine months of 2007 compared to \$33.4 million in the first nine months of 2006, representing an improvement of \$7.1 million. Additional revenue of \$16.2 million and lower administrative costs of \$5.3 million were partially offset by higher operating and lease costs of \$14.4 million, with labour-related costs representing \$11.3 million of the increase. General and administrative costs of the Canadian operations declined to \$14.6 million in the first nine months of 2007 from \$19.9 million in the first nine months of 2006, as a result of lower salaries and benefits primarily due to the Reorganization.

Depreciation, Amortization and Accretion

Depreciation, amortization and accretion costs were higher by \$0.9 million in the first nine months of 2007 from the first nine months of 2006 primarily due to acquisitions and construction, and included a favourable impact of \$0.7 million due to the stronger Canadian dollar.

Interest

Interest expense, net of interest income, increased \$6.8 million in the first nine months of 2007 from the first nine months of 2006. Excluding a favourable impact of \$0.8 million from the stronger Canadian dollar, net interest costs increased \$7.6 million between periods due to higher debt levels associated with the Reorganization, acquisitions and construction, partially offset by higher interest income from cash and short-term investments.

Income Taxes

The tax provision from continuing operations was \$30.1 million in the first nine months of 2007 compared to \$19.1 million in the first nine months of 2006. The effective tax rate for the first nine months of 2007 was 32.6% compared to 83.5% in the first nine months of 2006, both of which were distorted by the gains and losses from derivative financial instruments, foreign exchange, restructuring charges, asset disposals and other items, as well as withholding taxes associated with the Reorganization. Excluding these items, the effective tax rate for the first nine months of 2007 was 33.6% compared to 29.7% in the first nine months of 2006. In addition, the tax provisions in both years were impacted by tax credit adjustments as follows: a current income tax credit of \$1.4 million in the first quarter of 2007 for a book-to-file adjustment related to 2006 withholding tax; future income tax credits related to the expiration of certain statutes of limitations of U.S. tax liabilities of \$4.2 million in 2006; and a future income tax credit of \$0.8 million in the second quarter of 2006 related to a reduction in Canadian tax rates. Excluding these items, the effective tax rate for the first nine months of 2007 would have been 35.7% compared to 38.4% in the first nine months of 2006, with the lower effective tax rate in 2007 due primarily to a shift in income between taxable and non-taxable entities.

The tax provision, included a provision for SIFT tax of \$3.5 million, of which \$0.2 million is future income tax, for the nine months ended September 30, 2007. The provision represents management's estimate based on its understanding of the SIFT Rules and the REIT's current structure. For further information on this, refer to the discussion under "Significant Developments – Canadian Federal Income Tax on Income Trusts".

Share of Equity Accounted Earnings

The share of equity accounted earnings was \$1.5 million in the first nine months of 2007 compared to \$3.7 million in the first nine months of 2006. On July 5, 2007, Extendicare finalized the sale of its investment in Crown Life. For further information on this, refer to "Significant Developments – Investment in Crown Life Insurance Company".

Liquidity and Capital Resources

Sources and Uses of Cash

At September 30, 2007, the REIT had cash and cash equivalents of \$177.8 million compared with \$28.1 million at December 31, 2006.

| | Three months | | Nine months | | Year |
|---|-----------------|----------|-----------------|----------|-----------|
| | ended September | | ended September | | |
| <i>(thousands of dollars unless otherwise noted)</i> | 2007 | 2006 | 2007 | 2006 | 2006 |
| Cash provided by operating activities, before working capital changes | 29,503 | 42,339 | 82,872 | 103,791 | 140,668 |
| Net change in operating assets and liabilities | 4,539 | (12,457) | 4,851 | (18,596) | (11,884) |
| Cash provided by operating activities | 34,042 | 29,882 | 87,723 | 85,195 | 128,784 |
| Cash provided by (used in) investing activities | 9,962 | (34,779) | 4,583 | (84,715) | (114,094) |
| Cash provided by (used in) financing activities | (16,699) | 14,301 | 63,686 | 19,429 | (9,434) |
| Foreign exchange gain (loss) on U.S. cash held | (1,392) | (47) | (6,237) | (241) | 192 |
| Increase in cash and cash equivalents | 25,913 | 9,357 | 149,755 | 19,668 | 5,448 |
| Cash and cash equivalents at beginning of period | 151,899 | 32,920 | 28,057 | 22,609 | 22,609 |
| Cash and cash equivalents at period end | 177,812 | 42,277 | 177,812 | 42,277 | 28,057 |
| Average US/Canadian dollar exchange rate | 1.0477 | 1.1216 | 1.1055 | 1.1326 | 1.1341 |

Management's Discussion and Analysis

Cash flow provided by operating activities was \$87.7 million in the first nine months of 2007 compared to \$85.2 million in the first nine months of 2006. Cash provided by operating activities includes discontinued operations, which in 2006 included ALC. In the first nine months of 2007, the source of cash for the net change in operating assets and liabilities of \$4.9 million resulted primarily from a recovery of income tax instalments relating to operations, partially offset by a reduction in accounts payable and accrued liabilities. Cash used in reducing accounts payable in the first nine of 2007 was primarily due to a payment in January 2007 of an amount owing on prior year Medicare settlements of approximately \$14.0 million. The income taxes paid in March 2007 associated with the gain on distribution of ALC was reported in financing activities on the cash flow statement.

Cash provided by investing activities was \$4.6 million in the first nine months of 2007 compared to a use of cash of \$84.7 million in the first nine months of 2006. The activity in 2007 included proceeds from the disposal of Extencicare's investment in Crown Life of \$81.4 million (see "Significant Developments – Investment in Crown Life Insurance Company"). Acquisitions, net of cash acquired, cost \$24.6 million in the first nine months of 2007, and related to the purchase of: a previously leased Ohio nursing facility in January 2007 for \$8.7 million; the acquisition of a 191-bed nursing home in Wisconsin for \$2.8 million in May 2007; the acquisition of a 56-unit assisted living facility in Wisconsin for \$5.8 million; and the acquisition of a 99-bed nursing facility in Wisconsin for \$7.3 million. Acquisition costs of \$39.8 million in the first nine months of 2006 related to the purchase of two Pennsylvania nursing facilities (417 beds) in the 2006 first quarter and three Kentucky nursing facilities (259 beds) in August 2006.

Capital additions to property and equipment, excluding acquisitions, were \$53.1 million in the first nine months of 2007 compared to \$55.8 million in the first nine months of 2006. The table below breaks out the components of the property and equipment expenditures, which for 2006 included those of ALC. Growth expenditures of the REIT relate to the construction of new beds, building improvements or capital costs aimed at earnings growth. The sprinkler project was completed during 2006 and related to the voluntary installation of sprinkler systems in the older homes. The remaining costs are the capital costs to sustain and upgrade existing property and equipment assets. These costs were \$21.7 million in the first nine months of 2007 compared to \$22.3 million in the first nine months of 2006. These expenditures fluctuate on a quarterly basis with the timing of projects and seasonality. Management estimates that facility maintenance costs will be approximately \$34.0 million for the year 2007 compared to \$32.2 million in 2006, with the comparison to the prior year favourably impacted by \$1.5 million due to the stronger Canadian dollar. As a percent of revenue from continuing operations, the annual facility maintenance costs have been between 1.8% and 2.1% over the past three years.

| Capital Additions to Property and Equipment <i>(thousands of dollars unless otherwise noted)</i> | Three months ended September | | Nine months ended September | | Year |
|--|-------------------------------------|-------------|------------------------------------|-------------|-------------|
| | 2007 | 2006 | 2007 | 2006 | 2006 |
| REIT Operations | | | | | |
| Growth expenditures | 10,127 | 8,706 | 31,438 | 18,993 | 28,398 |
| Sprinkler project | – | 266 | – | 1,063 | 1,125 |
| Facility maintenance | 7,907 | 6,227 | 21,685 | 22,295 | 32,249 |
| | 18,034 | 15,199 | 53,123 | 42,351 | 61,772 |
| ALC operations distributed | – | 8,291 | – | 13,453 | 14,829 |
| Consolidated reported | 18,034 | 23,490 | 53,123 | 55,804 | 76,601 |
| Average US/Canadian dollar exchange rate | 1.0477 | 1.1216 | 1.1055 | 1.1326 | 1.1341 |

Net proceeds from dispositions of \$2.2 million in the first nine months of 2007 and \$1.9 million in the first nine months of 2006 related to the disposal of U.S. facilities held for sale. Other investment assets in the first nine months of 2007 were a use of funds of \$1.3 million and included deferred acquisition costs of \$5.1 million. Other investment assets in the first nine months of 2006 were a source of cash of \$9.0 million primarily from the collection of notes receivable and the sale of Omnicare shares.

Cash provided by financing activities was \$63.7 million in the first nine months of 2007 compared to \$19.4 million in the first nine months of 2006. The financing activities in 2007 included the issuance of new long-term debt in the first quarter primarily to finance the March 2007 income taxes owing on the distribution of ALC and the issuance of the 2014 Debentures in the second quarter. Distributions to unitholders in the first nine months of 2007 were \$62.1 million and included \$12.8 million related to distributions declared in 2006 and paid on January 15, 2007. The financing activities in the first nine months of 2006 related primarily to the issuance of long-term debt to finance acquisitions and costs associated with the Reorganization.

Capital Structure

| <i>(millions of dollars unless otherwise noted)</i> | September 30 2007 | December 31 2006 |
|---|----------------------|---------------------|
| REIT and Exchangeable LP units | 314.5 | 311.5 |
| Equity component of convertible debentures | 8.2 | – |
| Retained Earnings (Deficit) | | |
| Balance at beginning of period | (336.6) | 202.0 |
| Adjustment due to adoption of new accounting standards | 1.2 | – |
| Earnings (loss) for the period | 59.9 | (35.7) |
| Purchase of shares in excess of book value | – | (3.4) |
| Distribution of ALC | – | (476.5) |
| Unitholder distributions declared | (58.5) | (13.0) |
| Shareholder dividends | – | (10.0) |
| | (334.0) | (336.6) |
| Accumulated other comprehensive income | (4.7) | 1.4 |
| Unitholders' (deficiency) | (16.0) | (23.7) |
| Number of Units Outstanding (thousands, at period end) | | |
| REIT Units | 60,900.0 | 59,178.8 |
| Exchangeable LP Units | 9,490.4 | 11,026.2 |
| | 70,390.4 | 70,205.0 |
| Long-term Debt ⁽¹⁾ | | |
| Debt | 877.2 | 851.2 |
| Convertible debentures (face value) | 115.0 | – |
| | 992.2 | 851.2 |
| Adjusted Gross Book Value (AGBV) ⁽²⁾ | | |
| Total Assets | 1,277.5 | 1,315.2 |
| Accumulated depreciation and amortization | 417.8 | 439.0 |
| Incremental value | 675.0 | 675.0 |
| | 2,370.3 | 2,429.2 |
| Long-term Debt to AGBV | | |
| Excluding convertible debentures | 37.0% | 35.0% |
| Including convertible debentures | 41.9% | N/A |
| US/Canadian dollar exchange rate (at period end) | 0.9948 | 1.1654 |

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

⁽²⁾ Adjusted Gross Book Value 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.

| Unit Information (at October 31, 2007) | Number of Units Outstanding | Closing Market Value ⁽¹⁾ |
|---|--|--|
| REIT Units (TSX symbol: EXE.UN) | 60,912,956 | \$14.35 |
| Exchangeable LP Units | 9,490,519 | N/A |
| | 70,403,475 | |

⁽¹⁾ Per the Toronto Stock Exchange.

Management's Discussion and Analysis

The closing rates used to translate assets and liabilities of the U.S. operations were 0.9948 at September 30, 2007, and 1.1654 at December 31, 2006. As a result of the stronger Canadian dollar at the end of September 2007, and the disposal of the investment in Crown Life, the assets of the REIT's U.S. operations declined by approximately \$137.7 million and the liabilities declined by approximately \$131.3 million, with the net change resulting in a decrease in the foreign currency translation adjustment of \$6.4 million included in accumulated other comprehensive income.

Long-term Debt

Long-term debt, including current portion, was \$961.9 million at September 30, 2007, and was net of \$21.9 million of deferred financing costs. Due to a prospective change in accounting policy effective January 1, 2007, deferred financing costs were reclassified from other assets to long-term debt on the balance sheet. The balance of long-term debt excluding deferred financing costs was \$983.8 million, and reflected an increase of \$132.6 million from \$851.2 million at December 31, 2006. In January 2007 ECI and EHSI issued new mortgage financings of \$26.3 million and \$105.4 million (US\$90.0 million), respectively. In addition, the REIT issued the \$115.0 million of 2014 Debentures, of which \$106.3 million was classified as debt, and EHSI drew \$8.3 million (US\$7.5 million) on its Credit Facility during the 2007 third quarter. Further information on the new debt issued is provided under the heading "Significant Developments – Financings". Long-term debt increased \$132.6 million from the beginning of the year, as a result of these debt issuances of \$246.3 million and \$0.2 million of accretion to face value of the 2014 Debentures, partially offset by scheduled debt repayments of \$11.2 million and a decrease of \$102.7 million due to the change in the foreign exchange rate. EHSI's US\$90.0 million, 2012 CMBS Financing, was used primarily to pay current taxes owing on the distribution of ALC in March 2007. A portion of the proceeds from the 2014 Debentures was used to repay the US\$46.0 million balance outstanding on EHSI's Credit Facility and to finance the Tendercare acquisition in October 2007. The remainder will be used to finance other strategic acquisitions, internal growth, and for other general business purposes. Deferred financing charges were \$21.9 million at September 30, 2007, of which \$3.6 million had been amortized to net interest expense during the first nine months of 2007.

In order for the REIT to meet its monthly distributions, management decided to limit the amount of debt that may be subject to changes in interest rates. As a result, with the exception of the US\$7.5 million drawn on EHSI's Credit Facility, all of the long-term debt outstanding at September 30, 2007, was at fixed rates. The weighted average interest rate of all long-term debt at September 30, 2007, based on the face value of the debt, was 6.8% compared to 7.2% at December 31, 2006.

Extendicare REIT's financial position continues to be strong, with long-term debt (at face value and including current portion) representing 41.9% of AGBV at September 30, 2007. Excluding the 2014 Debentures, debt to AGBV was 37.0% at September 30, 2007. On a pro forma basis, reflecting the October 31, 2007, acquisition of Tendercare, these ratios would increase to approximately 44.0% and 40.0%, respectively.

The amount available to be borrowed under EHSI's Credit Facility is the lesser of: (1) 60% of the appraised values of the nursing facilities collateralizing the Credit Facility, or (2) an amount based on the actual net cash flow of these facilities for the last 12 months. The amount available to be borrowed as of September 30, 2007 was US\$95.1 million, of which EHSI had US\$7.5 million drawn and US\$17.5 million securing outstanding letters of credit, leaving the unused portion of the Credit Facility at US\$70.1 million.

EHSI was in compliance with all of its respective financial covenants as of September 30, 2007.

On June 29, 2007, Extendicare amended its RBC Credit Facility to increase its availability from \$50.0 million to \$70.0 million. It is primarily used to back letters of credit, of which there were \$63.9 million issued and outstanding as at September 30, 2007, leaving \$6.1 million available. The letters of credit secure \$45.1 million of Extendicare's pension obligations and \$18.8 million of Extendicare's obligations for contingent liabilities in connection with the sale of Extendicare's investment in Crown Life.

Foreign Currency Forward Contracts

EHSI entered into foreign currency forward contracts to limit the exposure to converting its U.S. cash flow into Canadian dollars for distribution to the REIT unitholders. Under an October 2006 agreement that covers a 36-month period commencing on December 5, 2006, EHSI locked in the purchase of Canadian dollars at the fixed exchange rate of 1.1141 in exchange for US\$4.0 million per month. In June 2007, EHSI entered into an additional foreign currency forward contract to cover the 7-month period from December 2009 to June 2010. This contract provides for a range of exchange rates on acquiring Canadian dollars for US\$4.0 million each month, with the floor rate set at 1.00, the ceiling rate set at 1.1050, and the current exchange rate applied if it falls between these two rates.

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In addition, in September 2007, EHSI entered into a foreign currency forward contract under which it locked in the purchase of US\$76.2 million in exchange for \$80 million for settlement in October 2007, which was delivered via an intercompany advance from the Canadian operations from cash on hand to finance the Tendercare acquisition.

These foreign currency forward contracts are not designated as hedging instruments for accounting purposes and, therefore, future market value adjustments on these derivatives will be reflected through the statement of earnings. As of September 30, 2007, the fair value of the foreign currency forward contracts was an asset of \$9.4 million (US\$9.4 million) compared to a liability of \$5.3 million (US\$4.5 million) at December 31, 2006.

Future Liquidity and Capital Resources

Management believes 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 and maintenance capital expenditures, service debt obligations and pay declared distributions to unitholders. Capital additions to property and equipment, excluding acquisitions, are anticipated to be approximately \$78.0 million in 2007, with \$34.0 million directed towards sustaining and upgrading existing property and equipment and the remaining \$44.0 million directed towards organic growth initiatives. The REIT raises funds through the capital markets and debt financing to fund strategic acquisitions and growth capital expenditures.

At September 30, 2007, EHSI had US\$70.1 million available under its Credit Facility and cash on hand of US\$52.1 million. The Canadian operations had cash on hand of \$125.4 million and available bank lines of \$6.1 million. The October 31, 2007, acquisition of Tendercare utilized approximately US\$109.5 million of cash.

At September 30, 2007, outstanding capital expenditure commitments for EHSI totalled US\$18.6 million, and included US\$4.1 million related to construction projects with an estimated cost of US\$14.1 million, of which US\$8.3 million was spent through to September 30, 2007.

In August 2007 EHSI entered into an agreement to acquire a 60-bed skilled nursing facility and a 62-unit assisted living facility in Wisconsin for cash of US\$15.7 million. The acquisition is expected to close by the end of 2007.

Distributions

The current policy of each of the REIT and Extencicare LP is to pay distributions of \$0.0925 per REIT Unit and Exchangeable LP Unit, respectively, to the holders thereof on a monthly basis. The declaration and payment of future distributions is subject to the discretion of the Board of Trustees and will be dependent upon a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of the REIT, debt covenants and obligations, and any other factors deemed relevant by the Board of Trustees. If the Trustees determine that it would be in the REIT's best interests, they may reduce, for any period, the percentage of Distributable Income to be distributed, which will result in corresponding reductions in distributions on Exchangeable LP Units.

Approximately 73% of Extencicare REIT's distributions in 2006 were characterized as non-taxable returns of capital in Extencicare REIT's indirect investment in its subsidiaries. Management believes that it is likely that approximately 70% of Extencicare REIT's distributions in 2007 will also be characterized as tax deferred returns of capital. To the extent a portion of the remaining 30% of the 2007 distributions are dividends, those paid to Canadian residents will be eligible dividends as per the Canadian Income Tax Act.

In the first nine months of 2007, Extencicare REIT generated Distributable Income of \$81.5 million and Adjusted Funds from Operations of \$70.2 million. The Board of Trustees of the REIT declared distributions totalling \$58.5 million in the first nine months of 2007, representing \$55.5 million in cash and \$3.0 million by way of issued units under a distribution reinvestment plan, to holders of REIT Units and Exchangeable LP Units.

There are a number of factors that affect the quarterly funds generated for distribution that the 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 "2007 Third Quarter Results" and "2007 Nine Month Results". Facility maintenance capital expenditures made in the first nine months of 2007 of \$21.7 million were behind the expected annual run rate of \$34.0 million based on the level of operations during the period.

Management's Discussion and Analysis

The following tables provide a reconciliation of the net earnings (loss) to Funds from Operations, Distributable Income and Adjusted Funds from Operations for the three months ended September 30, 2007.

| <i>(thousands of dollars unless otherwise noted)</i> | Three months ended September 2007 | | |
|---|--|--------------------------------|---------------|
| | Continuing Operations | Discontinued Operations | Total |
| Net earnings (loss) | 16,572 | (344) | 16,228 |
| Adjustments: | | | |
| Depreciation and amortization expense | 11,805 | (2) | 11,803 |
| Deduct depreciation for FFEC | (3,360) | – | (3,360) |
| Accretion expense | 317 | 15 | 332 |
| Gain on derivative financial instruments and foreign exchange | (3,425) | – | (3,425) |
| Current tax recovery on gain from derivatives and foreign exchange | (195) | – | (195) |
| Future income taxes | 2,905 | 112 | 3,017 |
| Funds from operations, before working capital changes ⁽¹⁾ | 24,619 | (219) | 24,400 |
| Amortization of deferred financing costs | 1,572 | – | 1,572 |
| Principal portion of government capital funding payments | 510 | – | 510 |
| Distributable income ⁽¹⁾ | 26,701 | (219) | 26,482 |
| Additional maintenance capital expenditures ⁽²⁾ | (4,547) | – | (4,547) |
| Adjusted funds from operations ⁽¹⁾ | 22,154 | (219) | 21,935 |
| Funds from Operations per Unit (\$) | | | |
| Basic | 0.350 | (0.003) | 0.347 |
| Diluted | 0.340 | (0.004) | 0.336 |
| Distributable Income per Unit (\$) | | | |
| Basic | 0.380 | (0.004) | 0.376 |
| Diluted | 0.361 | (0.004) | 0.357 |
| Adjusted Funds from Operations per Unit (\$) | | | |
| Basic | 0.315 | (0.004) | 0.311 |
| Diluted | 0.300 | (0.002) | 0.298 |
| Distributions | | | |
| Declared | | | 19,530 |
| Declared per unit (\$) | | | 0.2775 |
| Weighted Average Number of Units (thousands) | | | |
| Basic | | | 70,372 |
| Diluted | | | 76,151 |

⁽¹⁾ “Funds from operations”, “distributable income” and “adjusted funds from operations” 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 of \$7,907 less depreciation for furniture, fixtures, equipment and computers (FFEC) of \$3,360 already deducted in determining Distributable Income.

Management's Discussion and Analysis

The following tables provide a reconciliation of the net earnings (loss) to Funds from Operations, Distributable Income and Adjusted Funds from Operations for the nine months ended September 30, 2007.

| <i>(thousands of dollars unless otherwise noted)</i> | Nine months ended September 2007 | | |
|--|---|------------------------------------|---------------|
| | Continuing Operations | Discontinued Operations | Total |
| Net earnings (loss) | 63,860 | (3,957) | 59,903 |
| Adjustments: | | | |
| Depreciation and amortization expense | 36,825 | 101 | 36,926 |
| Deduct depreciation for FFEC | (10,400) | – | (10,400) |
| Accretion expense | 989 | 52 | 1,041 |
| Gain on derivative financial instruments and foreign exchange | (20,479) | – | (20,479) |
| Loss (gain) from asset impairment, disposals and other items | (2,192) | 5,675 | 3,483 |
| Current tax expense on loss (gain) from derivatives, foreign exchange, asset impairment, disposals and other items | 569 | 127 | 696 |
| Future income taxes | 8,776 | (2,260) | 6,516 |
| Share of undistributed equity accounted earnings | (1,541) | – | (1,541) |
| Funds from operations, before working capital changes ⁽¹⁾ | 76,407 | (262) | 76,145 |
| Amortization of deferred financing costs | 3,810 | – | 3,810 |
| Principal portion of government capital funding payments | 1,534 | – | 1,534 |
| Distributable income ⁽¹⁾ | 81,751 | (262) | 81,489 |
| Additional maintenance capital expenditures ⁽²⁾ | (11,285) | – | (11,285) |
| Adjusted funds from operations ⁽¹⁾ | 70,466 | (262) | 70,204 |
| Funds from Operations per Unit (\$) | | | |
| Basic | 1.087 | (0.004) | 1.083 |
| Diluted | 1.074 | (0.004) | 1.070 |
| Distributable Income per Unit (\$) | | | |
| Basic | 1.163 | (0.004) | 1.159 |
| Diluted | 1.141 | (0.004) | 1.137 |
| Adjusted Funds from Operations per Unit (\$) | | | |
| Basic | 1.002 | (0.004) | 0.998 |
| Diluted | 0.985 | (0.003) | 0.982 |
| Distributions | | | |
| Declared | | | 58,542 |
| Declared per unit (\$) | | | 0.8325 |
| Weighted Average Number of Units (thousands) | | | |
| Basic | | | 70,311 |
| Diluted | | | 72,449 |

⁽¹⁾ "Funds from operations", "distributable income" and "adjusted funds from operations" 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 of \$21,685 less depreciation for furniture, fixtures, equipment and computers (FFEC) of \$10,400 already deducted in determining Distributable Income.

Management's Discussion and Analysis

The following tables provide a reconciliation of the cash provided by operating activities to Distributable Income and Adjusted Funds from Operations for the three and nine months ended September 30, 2007.

| <i>(thousands of dollars)</i> | Three months ended Sept. 2007 | Nine months ended Sept. 2007 |
|--|--|---|
| Cash provided by operating activities | 34,042 | 87,723 |
| Add (deduct): | | |
| Net change in operating assets and liabilities | (4,539) | (4,851) |
| Current tax expense (recovery) on loss (gain) from derivatives, foreign exchange, asset impairment, disposals and other items | (195) | 696 |
| Net provisions and payments for self-insured liabilities | (103) | 6,142 |
| Depreciation on FFEC | (3,360) | (10,400) |
| Principal portion of government capital funding payments | 510 | 1,534 |
| Other | 127 | 645 |
| Distributable income ⁽¹⁾ | 26,482 | 81,489 |
| Additional maintenance capital expenditures ⁽²⁾ | (4,547) | (11,285) |
| Adjusted funds from operations ⁽¹⁾ | 21,935 | 70,204 |

⁽¹⁾ "Distributable income" and "adjusted funds from operations" 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 Distributable Income.

Contractual Obligations

The table below provides aggregated information about the contractual obligations at September 30, 2007, excluding self-insured liabilities, pension and other retirement benefit obligations. As well, it excludes conditional asset retirement obligations totalling \$19.7 million as of September 30, 2007, due to the uncertainty as to the timing of payments to be made under these obligations.

| <i>(millions of dollars)</i> | Total | To the end of 2007 | 2008 – 2009 | 2010 – 2011 | After 2011 |
|---|--------------|-------------------------------|------------------------|------------------------|-----------------------|
| REIT convertible debentures (face value) | 115.0 | – | – | – | 115.0 |
| Canadian Subsidiary Operations | | | | | |
| Long-term debt | 151.4 | 1.8 | 27.5 | 12.6 | 109.5 |
| Capital lease obligations | 254.6 | 3.2 | 25.9 | 25.9 | 199.6 |
| Operating lease obligations | 7.1 | 0.5 | 3.6 | 2.9 | 0.1 |
| United States Subsidiary Operations | | | | | |
| Long-term debt | 596.5 | 0.5 | 10.7 | 499.6 | 85.7 |
| Operating lease obligations | 37.7 | 1.8 | 13.4 | 9.8 | 12.7 |
| Purchase obligations | 18.5 | 18.5 | – | – | – |

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

Accrual for Self-insured Liabilities

At September 30, 2007, the accrual for self-insured general and professional liabilities was \$45.5 million compared to \$59.8 million at the beginning of the year. Claims payments, net of the current period provision, decreased the accrual by \$6.1 million in the first nine months of 2007, and the change in the foreign exchange rate further decreased it by \$8.2 million. The accrual for self-insured liabilities includes estimates of the costs of both reported claims and claims incurred but not yet reported. Provisions recorded in each of the first nine months of 2007 and 2006 for potential general and professional liability claims were \$8.8 million. Payments for self-insured liabilities during the first nine months of 2007 and 2006 were \$15.0 million and \$12.6 million, respectively. The increase in payments in 2007 over 2006 related to ceased operations. Payments made for resident care liability claims have been in excess of the current accrual levels because claims related to ceased operations are still being settled, for which provisions were previously recorded. EHSI exited the nursing home markets of the highly litigious States of Florida and Texas in 2000 and 2001, respectively. Payments made for these claims have tapered off, reflecting the wind-down of claims associated with these ceased operations. Exclusive of claims pertaining to these disposed operations, the growth of claims has increased, but within management's projections. An interim independent actuarial review was completed as part of the 2007 third quarter financial reporting process, which

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confirmed the adequacy of the balance of the reserves for resident care liability claims as at September 30, 2007. Management estimates that \$17.4 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly in management's control and therefore, estimates could change in the future. Management believes Extencicare has provided sufficient reserves as of September 30, 2007 for estimated costs of self-insured liabilities.

Extencicare invests funds to support the accrual for self-insured liabilities. These funds are reported in other assets and totalled \$37.2 million at September 30, 2007 compared to \$54.7 million at the end of 2006. 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 that Extencicare has sufficient cash resources to meet its estimated current claims payment obligations.

Off-balance Sheet Arrangements

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

The Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payments for the LTC leases for the calendar years 2007 and 2008 are US\$10.2 million and US\$10.7 million, respectively. The minimum rent will increase by 2% over the prior year's minimum rent for each of the calendar years 2009 through 2014. Annual minimum rent during any renewal term will increase by a minimum of 2% over the minimum rent of the immediately preceding year.

Credit and Interest Rates

In order for the REIT to meet its monthly distributions, management decided to limit the amount of debt that may be subject to changes in interest rates. As a result, with the exception of EHSI's Credit Facility, all of the long-term debt is at fixed rates. At September 30, 2007, there was US\$7.5 million drawn on EHSI's Credit Facility. The weighted average interest rate of all long-term debt at September 30, 2007, based on the face value of the debt, was approximately 6.8% compared to 7.2% at December 31, 2006. The weighted average interest rate of long-term debt at September 30, 2007 for the Canadian and U.S. operations was 7.1% and 6.7%, respectively, compared to 8.6% and 6.7% at December 31, 2006, respectively.

Foreign Currency Translation

The majority of the REIT's operations are conducted in the United States through self-sustaining operations, which accounted for 68.5% of continuing revenue in the first nine months of 2007. The REIT is therefore subject to foreign currency fluctuations which could adversely impact its financial position and operating results. As well, changes in the currency exchange rates could adversely affect the cash distributions to unitholders.

To limit this risk, EHSI has entered into two forward contracts to acquire Canadian dollars on a monthly basis to June 2010. The first contract locks in EHSI's exchange rate to acquire Canadian dollars for US\$4.0 million each month at 1.1141 for a 36-month period that commenced in December 2006 and ends in November 2009. In June 2007, EHSI entered into an additional foreign currency forward contract to cover the 7-month period from December 2009 to June 2010. This contract provides for a range of exchange rates on acquiring Canadian dollars for US\$4.0 million each month, with the floor rate set at 1.00, the ceiling rate set at 1.1050, and the current exchange rate applied if it falls between these two rates.

The translation effect of the strengthening of the Canadian dollar on the REIT's earnings for the three and nine months ended September 30, 2007, is summarized on page 17. Health care earnings from U.S. continuing operations for the nine months ended September 30, 2007, excluding any separately reported gains or losses, were US\$32.8 million. Annualizing these U.S. earnings, every one cent increase (decrease) in the Canadian dollar against the U.S. dollar would decrease (increase) the REIT's earnings from continuing operations by approximately \$0.4 million. A similar change in the Canadian dollar would decrease (increase) the net assets of the U.S. operations by approximately \$0.1 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive income.

Changes in Accounting Policies

The REIT's significant accounting policies are set out in *note 1* of the audited consolidated financial statements of the REIT's 2006 Annual Report. During 2007 the REIT adopted the following new accounting policy as a result of new accounting standards, which are more fully described in *note 2* of the unaudited consolidated financial statements for the nine months ended September 30, 2007.

Financial Instruments, Hedges and Comprehensive Income

Effective January 1, 2007, the REIT adopted three new CICA accounting standards: Section 3855 "Financial Instruments – Recognition and Measurement"; Section 3865 "Hedges"; and Section 1530 "Comprehensive Income". These accounting standards introduced new requirements for the recognition and measurement of financial instruments, the application of hedge accounting and the reporting of comprehensive income designed to harmonize Canadian accounting standards with U.S. and International Financial Reporting Standards. The new standards require financial assets and liabilities, including derivative financial instruments, to be carried at fair value. The fair values are recognized in opening equity and results for prior periods are not restated. Unrealized gains and losses on financial assets that are designated as available for sale, unrealized foreign currency translation amounts arising from self-sustaining foreign operations, and changes in the fair value of cash flow hedging instruments, are recorded as accumulated other comprehensive income and form part of unitholders' equity.

The following reflects the adjustments made on January 1, 2007, and the impact during the first nine months to 2007 to the REIT's balance sheet to adopt the new requirements.

| <i>(thousands of dollars)</i> | Sept. 30 2007 |
|--|--------------------------|
| Investments Held for Self-insured Liabilities | |
| Transition adjustment on adoption – unrealized gain on available-for-sale securities | 376 |
| Other comprehensive income during the period | |
| Net unrealized gains on available-for-sale securities | 510 |
| Reclassification of gain on available-for-sale securities to earnings | (349) |
| | <u>537</u> |
| Equity Accounted Investments | |
| Transition adjustment on adoption of financial instruments | |
| Retained earnings | 1,208 |
| Other comprehensive income | 4,272 |
| Net change in other comprehensive income during the period | (2,240) |
| Impact prior to disposal in July 2007 | <u>3,240</u> |
| Deferred financing costs: Transition adjustment on adoption – amortization | (11) |
| Future Income Tax, Net Asset (Liability) | |
| Transition adjustment on adoption | (127) |
| Other comprehensive income during the period | (58) |
| | <u>(185)</u> |
| Retained Earnings (Deficit) | |
| Transition adjustment on adoption of financial instruments | |
| Amortization of deferred financing costs (net of tax of \$4) | (7) |
| Share of equity accounted investments | 1,208 |
| | <u>1,201</u> |

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| <i>(thousands of dollars)</i> | Sept. 30 2007 |
|---|--------------------------|
| Accumulated Other Comprehensive Income | |
| Transition adjustment on adoption – unrealized gain on available-for-sale securities (net of tax of \$131) | 245 |
| Net change in unrealized gains on available-for-sale securities (net of tax of \$58) | 103 |
| Reclassification of foreign currency translation adjustments | (2,596) |
| Net change in foreign currency translation adjustments | (2,413) |
| | (4,661) |
| Share of equity accounted other comprehensive income | |
| Transition adjustment on adoption of financial instruments | 4,272 |
| Reclassification of foreign currency translation adjustments | 4,013 |
| Net change in foreign currency translation adjustments | (2,331) |
| Net change in unrealized gains on financial instruments | (2,240) |
| Disposal of equity accounted investment in July 2007 | (3,714) |
| | – |
| Balance at end of period | (4,661) |

Cash Flow Statements

Effective January 1, 2007, CICA amended Section 1540 “Cash Flow Statements” to modify the disclosure requirements pertaining to cash distributions made in accordance with contractual agreements or relevant constating documents, such as disclosing the terms and conditions in determining the cash distributions made and the extent to which the distributions are non-discretionary.

New Accounting Policies

The following are new accounting policies that have been issued, and will impact the REIT at a future date.

In December 2006 the CICA issued Section 3862 “Financial Instruments – Disclosures” and Section 3863 “Financial Instruments – Presentation”, which together replace Section 3861 “Financial Instruments – Disclosure and Presentation”. These new standards carry forward the existing presentation requirements and revise and enhance the disclosure requirements, such as specific disclosures to be made when an entity defaults or breaches a loan agreement. The new sections are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, with earlier adoption encouraged.

In December 2006 the CICA issued Section 1535 “Capital Disclosures”, which requires, among other things, disclosure of an entity’s objectives, policies, and processes for managing capital, and quantitative data about what the entity regards as capital. Section 3862 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, with earlier adoption encouraged.

Additional Information

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

FORWARD-LOOKING STATEMENTS

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

Forward-looking statements reflect management's beliefs and assumptions and are based on information currently available, and the REIT assumes no obligation to update any forward-looking statement. These statements are not guarantees of future performance and 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 health care industry in general and the long-term care industry in particular because of political and economic influences; changes in regulations governing the industry and the compliance of the REIT and its subsidiaries with such regulations; changes in government funding levels for health care services; changes in tax laws; resident care 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; the successful integration of the Tendercare acquisition; changes in foreign exchange rates; the ability to attract and retain qualified personnel; the availability and terms of capital to fund capital expenditures; changes in competition; and demographic changes.

Given these risks and uncertainties, readers are cautioned not to place undue reliance on the REIT's forward-looking statements.

Extendicare Real Estate Investment Trust
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|--------------------------|-----------------------------------|--------------------------|
| <i>(thousands of dollars except per unit/share amounts)</i> | 2007 | 2006 <i>(revised)</i> | 2007 | 2006 <i>(revised)</i> |
| Revenue | | | | |
| Nursing and assisted living centres | | | | |
| United States | 279,653 | 284,675 | 874,829 | 840,432 |
| Canada | 105,155 | 101,313 | 308,829 | 295,686 |
| Outpatient therapy – United States | 2,986 | 2,525 | 9,481 | 9,025 |
| Home health – Canada | 35,200 | 34,474 | 105,603 | 103,476 |
| Other | 11,028 | 11,017 | 36,030 | 32,038 |
| | 434,022 | 434,004 | 1,334,772 | 1,280,657 |
| Operating expenses | 363,876 | 366,222 | 1,118,743 | 1,079,387 |
| Administrative costs | 15,650 | 16,459 | 48,617 | 52,833 |
| Lease costs | 3,093 | 3,338 | 9,342 | 10,273 |
| | 382,619 | 386,019 | 1,176,702 | 1,142,493 |
| Earnings before undernoted | 51,403 | 47,985 | 158,070 | 138,164 |
| Depreciation and amortization | 11,805 | 11,973 | 36,825 | 35,932 |
| Accretion expense | 317 | 314 | 989 | 949 |
| Interest expense, net | 16,541 | 14,678 | 50,515 | 43,747 |
| Loss (gain) on derivative financial instruments and foreign exchange <i>(note 10)</i> | (3,425) | 16,627 | (20,479) | 16,165 |
| Loss (gain) from restructuring charges, asset disposals and other items <i>(note 4)</i> | – | 12,755 | (2,192) | 18,483 |
| Earnings (loss) from continuing health care operations before income taxes | 26,165 | (8,362) | 92,412 | 22,888 |
| Income tax expense (recovery) | | | | |
| Current | 6,688 | 469 | 21,317 | 14,469 |
| Future | 2,905 | (6,941) | 8,776 | (10,931) |
| Taxes associated with reorganization | – | – | – | 15,570 |
| | 9,593 | (6,472) | 30,093 | 19,108 |
| Earnings (loss) from continuing health care operations | 16,572 | (1,890) | 62,319 | 3,780 |
| Share of equity accounted earnings <i>(note 8)</i> | – | 1,239 | 1,541 | 3,692 |
| Earnings (loss) from continuing operations | 16,572 | (651) | 63,860 | 7,472 |
| Earnings (loss) from discontinued operations, net of income taxes <i>(note 5)</i> | (344) | 2,307 | (3,957) | 5,544 |
| Net earnings | 16,228 | 1,656 | 59,903 | 13,016 |
| Basic and Diluted Earnings (Loss) per Unit/Subordinate Voting Share <i>(note 12)</i> | | | | |
| Earnings (loss) from continuing operations | 0.23 | (0.01) | 0.90 | 0.11 |
| Net earnings | 0.23 | 0.02 | 0.85 | 0.19 |
| Basic and Diluted Earnings (Loss) per Multiple Voting Share <i>(note 12)</i> | | | | |
| Earnings (loss) from continuing operations | | (0.03) | | 0.04 |
| Net earnings | | – | | 0.12 |

See accompanying notes to unaudited consolidated financial statements

Extendicare Real Estate Investment Trust
CONSOLIDATED BALANCE SHEETS
(Unaudited)

| <i>(thousands of dollars)</i> | September 30 2007 | December 31 2006 <i>(revised)</i> |
|---|------------------------------|---|
| Assets | | |
| Current assets | | |
| Cash and short-term investments | 177,812 | 28,057 |
| Invested assets | 3,220 | – |
| Accounts receivable, less allowances of \$19,278 and \$16,684, respectively | 171,688 | 204,741 |
| Future income tax assets | 21,191 | 25,183 |
| Inventories, supplies and prepaid expenses | 23,016 | 20,048 |
| | 396,927 | 278,029 |
| Property and equipment | 685,903 | 729,274 |
| Goodwill and other intangible assets | 71,104 | 80,648 |
| Other assets <i>(note 6)</i> | 123,559 | 147,840 |
| | 1,277,493 | 1,235,791 |
| Equity accounted investments | – | 79,391 |
| | 1,277,493 | 1,315,182 |
| Liabilities and Unitholders' Deficiency | | |
| Current liabilities | | |
| Accounts payable | 24,124 | 52,583 |
| Accrued liabilities | 183,843 | 207,836 |
| Accrual for self-insured liabilities | 17,409 | 20,395 |
| Current portion of long-term debt <i>(note 9)</i> | 9,930 | 13,423 |
| Income taxes payable | 153 | 95,558 |
| | 235,459 | 389,795 |
| Accrual for self-insured liabilities | 28,093 | 39,386 |
| Long-term debt <i>(note 9)</i> | 951,932 | 837,757 |
| Other long-term liabilities | 61,277 | 59,312 |
| Future income tax liabilities | 16,698 | 12,586 |
| | 1,293,459 | 1,338,836 |
| Unitholders' deficiency | (15,966) | (23,654) |
| | 1,277,493 | 1,315,182 |

See accompanying notes to unaudited consolidated financial statements

Extendicare Real Estate Investment Trust
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| <i>(thousands of dollars)</i> | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|-------------------|-----------------------------------|-------------------|
| | 2007 | 2006 (revised) | 2007 | 2006 (revised) |
| Operating Activities | | | | |
| Net earnings | 16,228 | 1,656 | 59,903 | 13,016 |
| Adjustments for: | | | | |
| Depreciation and amortization | 11,803 | 16,829 | 36,926 | 50,573 |
| Provision for self-insured liabilities | 2,786 | 2,453 | 8,840 | 8,820 |
| Payments for self-insured liabilities | (2,683) | (2,680) | (14,982) | (12,573) |
| Future income taxes | 3,017 | (10,245) | 6,516 | 1,995 |
| Undistributed share of earnings from equity accounted investments | – | (1,239) | (1,541) | (3,692) |
| Loss (gain) on derivative financial instruments and foreign exchange <i>(note 10)</i> | (3,425) | 16,627 | (20,479) | 16,165 |
| Loss (gain) from restructuring charges, asset disposals and other items <i>(note 4)</i> | – | 12,755 | (2,192) | 18,483 |
| Loss from restructuring charges, asset impairment, disposals and other items from discontinued operations <i>(note 5)</i> | – | 5,650 | 5,675 | 10,079 |
| Other | 1,777 | 533 | 4,206 | 925 |
| | 29,503 | 42,339 | 82,872 | 103,791 |
| Net change in operating assets and liabilities: | | | | |
| Accounts receivable | (1,968) | (18,382) | 2,726 | (40,560) |
| Inventories, supplies and prepaid expenses | 2,016 | 624 | (3,511) | (3,969) |
| Accounts payable and accrued liabilities | (1,170) | 13,378 | (16,357) | 36,299 |
| Income taxes | 5,661 | (8,077) | 21,993 | (10,366) |
| | 34,042 | 29,882 | 87,723 | 85,195 |
| Investing Activities | | | | |
| Capital additions | (18,034) | (23,490) | (53,123) | (55,804) |
| Acquisitions, net of cash acquired <i>(note 3)</i> | (13,159) | (11,769) | (24,648) | (39,842) |
| Net proceeds from dispositions <i>(note 5)</i> | – | – | 2,228 | 1,944 |
| Sale/return of equity accounted investment <i>(note 8)</i> | 39,808 | – | 81,445 | – |
| Other assets | 1,347 | 480 | (1,319) | 8,987 |
| | 9,962 | (34,779) | 4,583 | (84,715) |
| Financing Activities | | | | |
| Issue of long-term debt | – | – | 246,695 | – |
| Issue on line of credit | 8,291 | 52,005 | 8,291 | 71,354 |
| Repayment of long-term debt | (5,740) | (2,490) | (11,161) | (7,444) |
| Decrease (increase) in investments held for self-insured liabilities | 1,824 | (1,711) | 11,832 | 3,228 |
| Purchase of shares for cancellation | – | (30) | – | (376) |
| Distributions/dividends paid | (19,000) | (3,281) | (62,050) | (9,870) |
| Transaction costs of reorganization <i>(notes 4 and 5)</i> | – | (13,267) | – | (20,906) |
| Financing costs | (45) | (21,205) | (9,995) | (21,205) |
| Income taxes paid re: the distribution of ALC <i>(note 9)</i> | – | – | (120,220) | – |
| Other | (2,029) | 4,280 | 294 | 4,648 |
| | (16,699) | 14,301 | 63,686 | 19,429 |
| Foreign exchange loss on cash held in foreign currency | (1,392) | (47) | (6,237) | (241) |
| Increase in cash and cash equivalents | 25,913 | 9,357 | 149,755 | 19,668 |
| Cash and cash equivalents at beginning of period | 151,899 | 32,920 | 28,057 | 22,609 |
| Cash and cash equivalents at end of period | 177,812 | 42,277 | 177,812 | 42,277 |
| Supplementary Information <i>(thousands of dollars)</i> | | | | |
| Cash interest paid in determination of earnings | 16,341 | 18,034 | 49,988 | 51,245 |
| Cash taxes paid | 298 | 11,002 | 116,811 | 33,134 |
| Units issued pursuant to Distribution Reinvestment Plan | 527 | – | 2,970 | – |

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

See accompanying notes to unaudited consolidated financial statements

Extendicare Real Estate Investment Trust
CONSOLIDATED STATEMENTS OF UNITHOLDERS' (DEFICIENCY)/SHAREHOLDERS' EQUITY
(Unaudited)

Nine months ended September 30

| <i>(thousands of dollars for amounts)</i> | 2007 | | 2006 | |
|--|-------------------|-----------------|-------------------|----------------|
| | <i>Number</i> | <i>Amount</i> | <i>Number</i> | <i>Amount</i> |
| Unit/Share Capital (note 11) | | | | |
| REIT Units | | | | |
| Issued and outstanding at beginning of period | 59,178,781 | 262,617 | | |
| Issued pursuant to Distribution Reinvestment Plan | 170,057 | 2,731 | | |
| Converted from Exchangeable LP Units | 1,551,135 | 6,898 | | |
| Issued and outstanding at end of period | 60,899,973 | 272,246 | | |
| Exchangeable LP Units | | | | |
| Issued and outstanding at beginning of period | 11,026,222 | 48,931 | | |
| Issued pursuant to Distribution Reinvestment Plan | 15,334 | 239 | | |
| Converted to REIT Units | (1,551,135) | (6,898) | | |
| Issued and outstanding at end of period | 9,490,421 | 42,272 | | |
| Equity portion of Convertible Debentures (note 9) | | 8,234 | | |
| Class I Preferred Shares | | | | |
| Cumulative Redeemable, Series 2 | | | | |
| Issued and outstanding at beginning of period | | | 88,805 | 2,219 |
| Purchased pursuant to obligation | | | (5,700) | (143) |
| To be redeemed on October 13, 2006 | | | (83,105) | (2,076) |
| Issued and outstanding at end of period | | | - | - |
| Adjustable Dividend, Series 3 | | | | |
| Issued and outstanding at beginning of period | | | 93,310 | 2,333 |
| Converted to Series 4 shares | | | (3,400) | (85) |
| To be redeemed on October 13, 2006 | | | (89,910) | (2,248) |
| Issued and outstanding at end of period | | | - | - |
| Adjustable Dividend, Series 4 | | | | |
| Issued and outstanding at beginning of period | | | 241,240 | 6,031 |
| Issued on conversion of Series 3 shares | | | 3,400 | 85 |
| To be redeemed on October 13, 2006 | | | (244,640) | (6,116) |
| Issued and outstanding at end of period | | | - | - |
| Class II Preferred Shares, Series 1 | | | | |
| To be redeemed on October 13, 2006 | | | 382,979 | 6,319 |
| Issued and outstanding at end of period | | | (382,979) | (6,319) |
| Subordinate Voting Shares | | | | |
| Issued and outstanding at beginning of period | | | 56,018,395 | 262,258 |
| Issued pursuant to options | | | 570,375 | 6,993 |
| Issued and outstanding at end of period | | | 56,588,770 | 269,251 |
| Multiple Voting Shares | | | | |
| Issued and outstanding at beginning of period | | | 11,791,433 | 29,340 |
| Purchased pursuant to issuer bid | | | (13,000) | (32) |
| Issued and outstanding at end of period | | | 11,778,433 | 29,308 |
| | 70,390,394 | 322,752 | 68,367,203 | 298,559 |
| Contributed surplus – fair value of stock options | | - | | 369 |
| Retained Earnings (Deficit) | | | | |
| Balance at beginning of period | | (336,619) | | 202,017 |
| Transition adjustment on adoption of financial instruments | | | | |
| Amortization of deferred financing costs (net of tax of \$4) (note 2) | | (7) | | - |
| Share of equity accounted investments (note 2) | | 1,208 | | - |
| Earnings for the period | | 59,903 | | 13,016 |
| Purchase of shares in excess of book, net | | - | | (3,456) |
| Distributions/dividends declared | | (58,542) | | (6,807) |
| Balance at end of period | | (334,057) | | 204,770 |
| Accumulated Other Comprehensive Income | | | | |
| Balance at beginning of period | | - | | - |
| Transition adjustment on adoption of financial instruments | | | | |
| Unrealized gain on available-for-sale securities (net of tax of \$131) (note 2) | | 245 | | - |
| Share of other comprehensive income of equity accounted investments (note 2) | | 4,272 | | - |
| Reclassification from foreign currency translation adjustments | | 1,417 | | (24,372) |
| Net change in unrealized gains on available-for-sale securities (net of tax of \$58) | | 103 | | - |
| Net change in foreign currency translation adjustments | | (2,413) | | (17,249) |
| Share of net change in Crown Life's accumulated other comprehensive income | | (8,285) | | - |
| Balance at end of period | | (4,661) | | (41,621) |
| | | (15,966) | | 462,077 |

See accompanying notes to unaudited consolidated financial statements

Extendicare Real Estate Investment Trust
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

| <i>(thousands of dollars)</i> | Three months ended | | Nine months ended | |
|--|--------------------|-------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2007 | 2006 | 2007 | 2006 |
| Net earnings | 16,228 | 1,656 | 59,903 | 13,016 |
| Other comprehensive income (loss), net of income taxes | | | | |
| Net unrealized gain on available-for-sale securities (net of tax of \$179 for the nine months ended September 30) | 219 | – | 331 | – |
| Reclassification of gain on available-for-sale securities to earnings (net of tax of \$121 for the nine months ended September 30) | – | – | (228) | – |
| | 219 | – | 103 | – |
| Net change in unrealized foreign currency translation gains (losses) (net of nil tax) | (1,585) | 521 | (2,413) | (17,249) |
| Share of net change in Crown Life's accumulated other comprehensive income | (3,714) | – | (8,285) | – |
| | (5,080) | 521 | (10,595) | (17,249) |
| Comprehensive income (loss) | 11,148 | 2,177 | 49,308 | (4,233) |

See accompanying notes to unaudited consolidated financial statements

Extendicare Real Estate Investment Trust
NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The unaudited interim period consolidated financial statements of Extendicare Real Estate Investment Trust (“Extendicare REIT” or the “REIT”) have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include those of Extendicare Inc. (“Extendicare” or the “Company”), an indirect wholly owned subsidiary of Extendicare REIT. Health care operations are conducted through wholly owned subsidiaries, Extendicare Health Services, Inc. and its subsidiaries (collectively “EHSI”) in the United States, and Extendicare (Canada) Inc. and its subsidiaries (collectively “ECI”) in Canada.

Extendicare REIT is the successor in interest to Extendicare resulting from the conversion of Extendicare to a real estate investment trust on November 10, 2006 pursuant to a plan of arrangement (the “Arrangement”). As well, Extendicare conducted a number of pre-Arrangement transactions to position itself for the Arrangement (the “Reorganization”). Extendicare REIT is an unincorporated, open-ended limited purpose trust established under the laws of the Province of Ontario pursuant to a deed of trust, dated September 11, 2006, as amended and restated on October 28, 2006 (the “Deed of Trust”). The conversion has been accounted for as a continuity of interest, and, accordingly, the consolidated financial statements of the REIT reflect the consolidated financial position, results of operations and cash flows as if the REIT had always carried on the business formerly carried on by Extendicare. Commencing with the year ended December 31, 2006, comparative information for the REIT relating to periods prior to the conversion is that of its predecessor, Extendicare Inc.

The preparation of financial data is based on accounting policies and practices consistent with those used in the preparation of the annual audited consolidated financial statements. All dollar amounts are in Canadian dollars unless otherwise indicated. These unaudited interim consolidated financial statements do not include all disclosures normally provided in annual consolidated financial statements and should be read together with the annual audited consolidated financial statements and the accompanying notes included in Extendicare REIT’s 2006 Annual Report.

Certain comparative figures for the 2006 reported periods have been reclassified to conform to the presentation in 2007, mainly for discontinued operations as described in *note 5*.

2. Change in Accounting Policy

Effective January 1, 2007, Extendicare REIT adopted three new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA): Handbook Section 1530, “Comprehensive Income”, Handbook Section 3855, “Financial Instruments – Recognition and Measurement”, and Handbook Section 3865, “Hedges”. Extendicare adopted these standards retroactively without restatement of prior periods.

Comprehensive Income

Section 1530 introduces comprehensive income, which consists of net income and other comprehensive income (OCI). OCI represents changes in unitholders’ equity during a period arising from transactions and other events with non-owner sources and includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations, and changes in the fair value of the effective portion of cash flow hedging instruments, if any. The REIT has included in its consolidated financial statements a consolidated statement of comprehensive income for the changes in these items during the three and nine month periods ending September 30, 2007, while the cumulative changes in OCI are included in accumulated other comprehensive income (AOCI), which is presented as a new category of unitholders’ equity on the consolidated balance sheet.

Notes to the Unaudited Interim Consolidated Financial Statements

Financial Instruments – Recognition and Measurement

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be recognized on the consolidated balance sheet when the REIT becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held for trading, available for sale, held to maturity, loans and receivables, or other financial liabilities. Transaction costs are expensed as incurred for financial instruments classified or designated as held for trading. For other financial instruments, transaction costs are capitalized on initial recognition. Financial assets and financial liabilities held for trading are measured at fair value with changes in those fair values recognized in net earnings. Financial assets held to maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest rate method of amortization. Available-for-sale financial assets are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in OCI, net of tax.

Derivative instruments are recorded on the consolidated balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts that are not closely related to the host contracts. Changes in the fair values of derivative instruments are recognized in net earnings with the exception of derivatives designated in effective cash flow hedges or hedges of foreign currency exposure of a net investment in a self-sustaining foreign operation. Section 3855 also provides an entity the option to designate a financial instrument as held for trading (the fair value option) on its initial recognition or upon adoption of the standard, even if the financial instrument, other than loans and receivables, was not acquired or incurred principally for the purpose of selling or repurchasing it in the near term. An instrument that is classified as held for trading by way of this fair value option must have reliable fair values.

Hedges

Section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied and the accounting for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of foreign currency exposures of net investments in self-sustaining foreign operations. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. In a fair value hedging relationship, the carrying value of the hedged item is adjusted for unrealized gains or losses attributable to the hedged risk and recognized in net earnings. Changes in the fair value of the hedged item, to the extent that the hedging relationship is effective, are offset by changes in the fair value of the hedging derivative, which is also recorded in net earnings. When hedge accounting is discontinued, the carrying value of the hedged item is no longer adjusted and the cumulative fair value adjustments to the carrying value of the hedged item are amortized to net earnings over the remaining term of the original hedging relationship. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in OCI while the ineffective portion is recognized in net earnings. When hedge accounting is discontinued, the amounts previously recognized in AOCI are reclassified to net earnings during the periods when the variability in the cash flows of the hedged item affects net earnings. Gains and losses on derivatives are reclassified immediately to net earnings when the hedged item is sold or early terminated. In hedging a foreign currency exposure of a net investment in a self-sustaining foreign operation, the effective portion of foreign exchange gains and losses on the hedging instruments is recognized in OCI and the ineffective portion is recognized in net earnings. The amounts previously recognized in AOCI are recognized in net earnings when there is a reduction in the hedged net investment as a result of a dilution or sale of the net investment, or reduction in equity of the foreign operation as a result of dividend distributions. Extencicare did not have hedges at December 31, 2006 or in the first nine months of 2007.

Impact of Adoption of Handbook Sections 1530, 3855, 3865

- (a) Upon adoption of these new standards, Extencicare designated its cash and short-term investments as held for trading, which are measured at fair value. Accounts, notes and mortgages receivable were classified as loans and receivables, which are measured at amortized cost. Bank indebtedness, accounts payable, accrued liabilities, long-term debt and capital lease obligations were classified as other financial liabilities, which are measured at amortized cost.

Notes to the Unaudited Interim Consolidated Financial Statements

The investments supporting Extendicare's self-insured general and professional liabilities were categorized as held to maturity and available for sale. The held-to-maturity investments were valued at amortized cost and continue to be valued at amortized cost subsequent to January 1, 2007, therefore there was no impact to Extendicare's financial statements for held-to-maturity securities. The available-for-sale securities, formerly at amortized cost, were designated as available for sale at January 1, 2007, with the resulting fair value transitional adjustment of \$0.2 million disclosed in AOCI, net of tax of \$0.1 million. An increase of \$0.1 million, net of tax of \$0.1 million, representing realized gains and increase in the fair value for available-for-sale securities, was reported in OCI in the nine months ended September 30, 2007.

On June 29, 2007, Extendicare received securities from Crown Life which are recorded as invested assets. These assets have been categorized as available for sale and are held at fair market value. There was no impact on OCI at September 30, 2007.

- (b) At January 1, 2007, the unamortized amount of deferred financing costs related to the issue of long-term debt was adjusted to use the effective interest rate method to determine the amortized cost, which resulted in a transitional adjustment to retained earnings of \$7,000, net of future tax of \$4,000. Deferred financing costs, formerly included in other assets, are now included as part of the carrying value of long-term debt (\$21.9 million at September 30, 2007).
- (c) All derivative instruments, including embedded derivatives, are recorded in the statement of earnings at fair value unless exempted from derivative treatment as a normal purchase and sale. All changes in their fair value are recorded in net earnings unless cash flow hedge accounting is used, in which case, changes in fair value are recorded in OCI. Extendicare has elected to apply this accounting treatment for all embedded derivatives in host contracts entered into on or after January 1, 2003. The impact of the change in accounting policy related to embedded derivatives was not material.

Commercial mortgage backed securitization financings of EHSI (the "CMBS Financings") were determined to contain embedded derivatives for prepayment options that were not closely related to the host debt and therefore, were bifurcated and separately fair valued. The host debt instruments were valued at amortized cost at January 1, 2007 and continue to be valued at amortized cost. The fair values of the prepayment options were determined to be immaterial and have not changed materially from January 1, 2007. Therefore, there is no adjustment to the consolidated financial statements in respect the CMBS Financings. Other mortgages financed since January 1, 2003 also contained prepayment options but were determined to be closely related to the host debt as the exercise price was approximately equal to the debt instrument's amortized cost and therefore, no adjustment to the consolidated financial statements was required.

Extendicare utilizes foreign currency forward contracts, which are derivatives, to limit the exposure of converting U.S. cash flow into Canadian dollars. These forward contracts are not designated as hedges for accounting purposes and changes in their fair values are recorded in net earnings.

- (d) As a transitional adjustment, Extendicare's foreign currency adjustment account of \$1.4 million in unitholders' equity, representing the accumulated net gain from the translation of its foreign operations, was reclassified to AOCI in unitholders' equity. Changes to the unrealized foreign currency adjustment account are disclosed in OCI with comparative figures for the prior periods disclosed.
- (e) As required under the new accounting policies for Handbook Sections 1530, 3855, and 3865, Extendicare has included its share of changes to opening retained earnings, AOCI and OCI of its equity accounted investment, Crown Life Insurance Company (Crown Life). Extendicare's share of transition adjustments for Crown Life increased retained earnings by \$1.2 million and increased AOCI by \$4.3 million, representing adjustments for available-for-sale investments and hedges of its net foreign investment. In July 2007, Extendicare completed the sale of its investment in Crown Life (*note 8*). Extendicare's share of Crown Life's OCI prior to the sale was a reduction of \$4.6 million.

Notes to the Unaudited Interim Consolidated Financial Statements

3. Acquisitions

In 2007, EHSI acquired the following facilities for cash of \$24.6 million (US\$22.8 million): a nursing facility in Wisconsin in September 2007; an assisted living facility in Wisconsin in August 2007; a nursing facility in Wisconsin in May 2007, of which EHSI plans to operate as an 80-bed nursing facility and to relocate the remaining beds to another facility; and a nursing facility it had been leasing in Ohio in January 2007.

The preliminary purchase price allocations are provided in the table below. EHSI will complete its valuation of net assets acquired by December 31, 2007. Based on this final valuation, the purchase price allocation for accounting purposes may be adjusted in future periods.

| | <i>Sept. 30/07</i> Wisconsin | <i>Aug. 1/07</i> Wisconsin | <i>May 1/07</i> Wisconsin | <i>Jan. 5/07</i> Ohio | Total |
|-------------------------------|--|--------------------------------------|-------------------------------------|---------------------------------|---------------|
| <i>(thousands of dollars)</i> | <i>(nursing – 99 beds)</i> | <i>(assist. liv. – 56 units)</i> | <i>(nursing – 191 beds)</i> | <i>(nursing – 111 beds)</i> | |
| Prepaid expenses | 26 | 7 | 47 | – | 80 |
| Property and equipment | 7,365 | 5,279 | 2,741 | 6,449 | 21,834 |
| Goodwill | 43 | 533 | – | 2,244 | 2,820 |
| Resident relationships | 37 | 55 | 29 | – | 121 |
| Total assets | 7,471 | 5,874 | 2,817 | 8,693 | 24,855 |
| Accrued liabilities | 94 | 92 | 21 | – | 207 |
| Purchase price – C\$ | 7,377 | 5,782 | 2,796 | 8,693 | 24,648 |
| <i>Purchase price – US\$</i> | <i>7,416</i> | <i>5,421</i> | <i>2,516</i> | <i>7,414</i> | <i>22,767</i> |

In 2006, EHSI acquired the following nursing facilities for cash of \$39.8 million (US\$35.1 million): three nursing facilities (259 beds) in Kentucky on August 1, 2006, and two nursing facilities (417 beds) in Pennsylvania on March 1, 2006.

Details of the transactions are as follows:

| | <i>Aug. 1/06</i> Kentucky | <i>Mar. 1/06</i> Pennsylvania | Total |
|-------------------------------|-------------------------------------|---|---------------|
| <i>(thousands of dollars)</i> | <i>(nursing – 259 beds)</i> | <i>(nursing – 417 beds)</i> | |
| Prepaid expenses | 54 | 112 | 166 |
| Property and equipment | 11,605 | 25,759 | 37,364 |
| Goodwill | 206 | 2,522 | 2,728 |
| Resident relationships | 80 | 169 | 249 |
| Total assets | 11,945 | 28,562 | 40,507 |
| Accrued liabilities | 176 | 489 | 665 |
| Purchase price – C\$ | 11,769 | 28,073 | 39,842 |
| <i>Purchase price – US\$</i> | <i>10,409</i> | <i>24,723</i> | <i>35,132</i> |

Notes to the Unaudited Interim Consolidated Financial Statements

4. Loss (Gain) from Restructuring Charges, Asset Disposals and Other Items

Extencicare REIT reported a gain of \$2.2 million for the nine months ended September 30, 2007, on the sale of non-core real estate with no book value.

For the third quarter and nine months ended September 30, 2006, Extencicare reported a loss of \$12.8 million and \$18.5 million, respectively, as a loss (gain) from restructuring charges, asset disposals and other items.

Extencicare incurred pre-tax restructuring charges in the third quarter and first nine months of 2006 in the amount of \$11.7 million and \$16.7 million, respectively, representing advisory and other professional fees related to the Reorganization it underwent in 2006.

In the third quarter of 2006, EHSI recorded a loss of \$0.8 million (US\$0.7 million) relating to the abandonment of a proposed assisted living project in Bainbridge, Washington.

In the second quarter of 2006, Extencicare sold other non-core assets for proceeds of \$0.4 million, resulting in a pre-tax gain of \$0.3 million, recorded a provision for severance of \$0.8 million and recorded an impairment charge for long-lived assets of \$0.1 million (US\$0.1 million).

In the first quarter of 2006, EHSI sold 50,000 of the 100,000 shares of Omnicare, Inc. it held for proceeds of \$3.5 million (US\$3.1 million), which resulted in a pre-tax gain of \$0.3 million (US\$0.3 million). For the remaining 50,000 Omnicare shares, unrealized losses of \$0.2 million and \$0.7 million were recognized for the third quarter and nine months ended September 30, 2006, respectively, to reduce the carrying value of its investment.

5. Discontinued Operations

The following is a summary of discontinued operations with prior periods revised for operations identified as discontinued in the first quarter of 2007.

| | Three months ended | | Nine months ended | |
|--|--------------------|---------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2007 | 2006 | 2007 | 2006 |
| <i>(thousands of dollars except per unit/share amounts)</i> | | | | |
| Revenue | 417 | 69,838 | 3,806 | 208,138 |
| Operating expenses | 1,009 | 49,040 | 7,349 | 146,448 |
| Administrative costs | – | 2,859 | – | 8,164 |
| Lease costs | 1 | 4,167 | 8 | 12,439 |
| Earnings (loss) before undernoted | (593) | 13,772 | (3,551) | 41,087 |
| Depreciation and amortization | (2) | 4,856 | 101 | 14,641 |
| Accretion expense | 15 | 27 | 52 | 80 |
| Interest expense, net | – | 1,383 | (1) | 4,685 |
| Earnings (loss) before the undernoted | (606) | 7,506 | (3,703) | 21,681 |
| Gain (loss) from asset impairment, disposals and other items | | | | |
| Impairment charges | – | (4,086) | (5,996) | (7,221) |
| Recoveries on sale of facilities and restructuring costs | – | (1,564) | 321 | (2,858) |
| | – | (5,650) | (5,675) | (10,079) |
| Earnings (loss) from discontinued operations before income taxes | (606) | 1,856 | (9,378) | 11,602 |
| Income tax expense (recovery) | (262) | (451) | (5,421) | 6,058 |
| Earnings (loss) from discontinued operations | (344) | 2,307 | (3,957) | 5,544 |
| Earnings (Loss) per Unit/Subordinate Voting Share | | | | |
| Basic and diluted | – | 0.03 | (0.05) | 0.08 |
| Earnings per Multiple Voting Share | | | | |
| Basic and diluted | | 0.03 | | 0.08 |

Notes to the Unaudited Interim Consolidated Financial Statements

Ohio Nursing Property

In the first quarter of 2007, due to poor financial performance and regulatory issues of the facility, EHSI decided to close a nursing facility (175 beds) located in Dayton, Ohio and actively pursue the disposition of the property. As a result, EHSI has reclassified the financial results of this facility to discontinued operations and recorded an impairment charge of \$6.0 million (US\$5.1 million) to reduce the property to its fair value of \$0.3 million (US\$0.3 million). The facility was closed in May 2007.

Texas and Washington Assisted Living Properties

In the first quarter of 2007, EHSI sold a 60-unit assisted living facility located in San Antonio, Texas, for proceeds of \$2.2 million (US\$1.9 million), resulting in a pre-tax recovery of \$0.2 million (US\$0.1 million). EHSI had previously closed and reclassified this operation to discontinued operations in the first quarter of 2006 due to poor financial performance and future capital needs. In the 2006 first quarter, EHSI recorded an impairment charge of \$2.0 million (US\$1.7 million) to reduce the property value to \$2.0 million (US\$1.8 million).

In addition, during the 2006 first quarter, the lease term for an assisted living facility located in Edmonds, Washington (63 units) ended and EHSI decided to terminate its operations due to poor financial performance. EHSI continued to operate the facility until September 2006 in order to assist the landlord in seeking an alternative operator or buyer of the property. As a result, the financial results of this facility were reclassified to discontinued operations. There was no gain or loss on disposition of the operations and leasehold interest.

ALC Operations

ALC was distributed to the Extencicare shareholders on November 10, 2006 as part of the Arrangement and the results of ALC and the 29 properties that were transferred to ALC have been reclassified as discontinued operations. For the nine months ended September 30, 2006, \$4.2 million in restructuring costs were incurred of which \$1.6 million was attributable to the third quarter of 2006. These were primarily professional fees for advisory, legal and audit services.

Ohio Assisted Living Property

In the third quarter of 2006, EHSI recorded an impairment charge for long-lived assets of \$3.4 million (US\$3.1 million) relating to an ALC assisted living facility in Ohio. The estimated undiscounted future cash flows were determined not to be sufficient to recover the carrying amounts of this facility and the charge was measured by comparing the fair value of the asset less estimated costs to sell to its carrying amount.

Minnesota Nursing Properties

Three Minnesota nursing properties were classified as discontinued operations at the end of December 2005. One of those facilities was sold in the first quarter of 2006 for cash proceeds of \$1.4 million (US\$1.2 million), resulting in a pre-tax recovery of \$1.1 million (US\$0.9 million). In April 2006, an additional property was sold for \$0.5 million (US\$0.5 million), which resulted in a pre-tax recovery of \$0.2 million (US\$0.2 million). EHSI continues to operate the third facility and therefore, its operating results were reclassified back to continuing operations for all reporting periods.

Wisconsin Nursing Facilities

In the second quarter of 2006, due to poor financial performance and future capital needs of a nursing facility (63 beds), EHSI decided to dispose of the facility, or close and actively pursue the disposition of this property, located in Milwaukee, Wisconsin. EHSI recorded an impairment charge of \$1.1 million (US\$1.0 million) to reduce the property value to \$0.3 million (US\$0.2 million), based upon its valuation of the property. In the third quarter of the same year, EHSI recorded an additional impairment charge of \$0.2 million to reduce the property value to nil.

In December 2005, EHSI sold its Lakeside nursing facility, located in Chippewa Falls, Wisconsin. The facility, which was formerly leased to an operator, was classified as a discontinued operation. In the first quarter of 2006, EHSI incurred a general liability punitive settlement of \$1.6 million (US\$1.4 million) pertaining to the period that EHSI operated the facility, which was classified as an operating cost in discontinued operations.

Oregon and Kentucky Properties

In the third quarter of 2006, EHSI incurred impairment charges of \$0.4 million (US\$0.4 million) for one assisted living facility in Oregon and a nursing facility in Kentucky.

Notes to the Unaudited Interim Consolidated Financial Statements

6. Other Assets

| <i>(thousands of dollars)</i> | September 30 2007 | December 31 2006 |
|--|----------------------|---------------------|
| Investments held for self-insured liabilities | | |
| Held-to-maturity securities, at amortized cost <i>(note 2)</i> | 5,785 | – |
| Available-for-sale securities, at fair value <i>(note 2)</i> | 31,393 | – |
| Investments, at amortized cost <i>(note 2)</i> | – | 54,705 |
| Notes and mortgages receivable | 62,574 | 57,122 |
| Other long-term receivables | 9,933 | 5,571 |
| Deferred charges <i>(note 2)</i> | 6,891 | 21,003 |
| Assets held for sale | 6,983 | 9,439 |
| | 123,559 | 147,840 |

The investments held for self-insured liabilities have been classified in accordance with Extencicare's adoption of the new accounting policy on January 1, 2007 for Financial Instruments – Recognition and Measurement as described in *note 2*. Also, under this new accounting policy, deferred financing costs are classified as part of the carrying value of long-term debt and prior periods are not restated. Total deferred financing costs included in deferred charges of other assets at December 31, 2006, was \$18.6 million. Assets held for sale of \$7.0 million at September 30, 2007, related to four Texas properties that were subsequently sold in November 2, 2007 for approximately their carrying value *(note 16)*.

7. Goodwill and Other Intangible Assets

As a result of the acquisitions made in 2007, goodwill increased by \$0.6 million (US\$0.6 million) for the quarter, and \$2.8 million (US\$2.5 million) year to date. As at September 30, 2007, intangible assets had a gross carrying value of \$10.4 million and accumulative amortization of \$10.3 million, for a net book value of \$0.1 million. The amortization expense for the third quarter was nil in 2007 (2006 – \$0.8 million) and \$0.3 million (2006 – \$2.5 million) year to date.

8. Equity Accounted Investments

The REIT's reported share of Crown Life's earnings for each of the nine-month periods ended September 30, 2007 and 2006 was \$1.5 million and \$3.9 million, respectively.

Extencicare completed the sale of its 34.7898% equity interest in Crown Life on July 5, 2007, for an aggregate \$86.1 million, net of transaction costs. The consideration included a dividend from Crown life in June and a cash payment from The Canada Life Assurance Company (Canada Life) for the shares of Crown Life in July. Post closing adjustments were agreed to at the end of September, with the final cash settlement of \$1.1 million received by Extencicare in October. Extencicare also completed a purchase and sale with HARO Financial Company (HARO) of certain securities it received with HARO on the Crown Life dividend in June. As a result of these transactions as at September 30, 2007, Extencicare received cash of \$81.4 million, net of transaction costs, and securities valued at \$3.6 million. Further details of the transaction are described below.

In 1998, an agreement was made to sell or indemnity reinsure substantially all of Crown Life's insurance business to Canada Life. The resulting comprehensive agreements provided for the closing of the sale of a significant portion of Crown Life's business effective January 1, 1999. The agreements between Canada Life and Crown Life and its principal shareholders, HARO and Extencicare, also provided that at any time after January 1, 2004, Canada Life may either acquire substantially all of the balance of Crown Life's insurance business or, at the election of Canada Life or Crown Life's principal shareholders, make an offer for all of the common shares of Crown Life (the "second closing"). On April 24, 2006, the shareholders of Crown Life filed notice with Canada Life to initiate the second closing.

On June 8, 2007, the second closing agreement was executed. On June 29, 2007, pursuant to this agreement, Extencicare received a dividend of \$45.2 million from Crown Life consisting of \$26.6 million in cash and \$18.6 million in securities. Extencicare also completed a purchase and sale with HARO of certain securities received from Crown Life as dividend. As a result of these transactions, Extencicare received cash of \$15.1 million and was left with securities of \$3.6 million. Proceeds, net of costs, of \$41.6 million have been reported as a return of equity on the statement of cash flows. There were no dividends paid by Crown Life in 2006.

Notes to the Unaudited Interim Consolidated Financial Statements

On July 5, 2007, Extencicare completed the sale of its investment in Crown Life, receiving a cash payment of \$40.0 million for its Crown Life shares from Canada Life. In September, the post closing adjustments were agreed to, with final settlement received in October. No gain or loss was recognized on the sale.

Under the Crown Life share sale agreement with Canada Life, Extencicare remains responsible for certain possible specified contingent claims against Crown Life of up to approximately \$18.8 million and in support of the claims, has delivered letters of credit to Crown Life in such amount drawn under its revolving line of credit with Royal Bank of Canada (the "RBC Credit Facility") (note 9). Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. The post closing adjustments included an adjustment to the contingent liabilities that was previously not included. As a result, management now estimates that Extencicare's aggregate liability for such claims will not exceed \$8.0 million, and has recorded a provision for this amount in other long-term liabilities on the balance sheet as of September 30, 2007.

9. Long-term Debt

| <i>(thousands of dollars)</i> | | Sept. 30 2007 | | Dec. 31 2006 |
|--|-------------|--------------------------|-------------|-------------------------|
| | <i>US\$</i> | | <i>US\$</i> | |
| EHSI (payable in US\$) | | | | |
| CMBS, 6.65%, due 2011 | 500,000 | 497,400 | 500,000 | 582,700 |
| Financing costs | (10,302) | (10,249) | – | – |
| CMBS, 6.79%, due 2012 | 90,000 | 89,532 | – | – |
| Financing costs | (2,367) | (2,355) | – | – |
| Line of credit under Credit Facility, variable rates, due 2009 | 7,500 | 7,461 | – | – |
| Financing costs | (2,420) | (2,407) | – | – |
| Mortgages and Industrial Development Revenue Bonds, 7.25% to 13.61%, due 2007 | – | – | 2,971 | 3,462 |
| Notes payable, 0% to 8.00%, maturing through to 2009 | 2,164 | 2,153 | 4,019 | 4,684 |
| | 584,575 | 581,535 | 506,990 | 590,846 |
| Extencicare REIT and Canadian Subsidiaries (payable in C\$) | | | | |
| Convertible Unsecured Subordinated Debentures, 5.7%, due 2014 | | 106,600 | | – |
| Financing costs | | (5,060) | | – |
| Mortgages, 4.63% to 9.81%, maturing through to 2017 | | 151,380 | | 129,057 |
| Financing costs | | (1,222) | | – |
| Obligations under capital leases, 7.28% to 8.00%, maturing through to 2028 | | 129,289 | | 131,277 |
| Financing costs | | (660) | | – |
| | | 380,327 | | 260,334 |
| | | 961,862 | | 851,180 |
| Less: current portion | | 9,930 | | 13,423 |
| | | 951,932 | | 837,757 |

Canada Mortgage and Housing Corporation (CMHC) Financing for Canadian Properties

On January 19, 2007, ECI completed \$26.3 million of CMHC financing secured by three of its Canadian nursing facilities. The three loans have 10-year terms with weighted average monthly payments amortized over 20-years at 4.67%.

Second Series of Commercial Mortgage Backed Securitization (CMBS) Financing

EHSI completed on March 6, 2007, a second series of CMBS financing for US\$90.0 million, due in 2012 (the "2012 CMBS Financing"), with a fixed interest rate of 6.79%. The 2012 CMBS Financing stipulates interest-only monthly payments for the first two years, and monthly payments of principal and interest based upon a 25-year amortization period thereafter. This series of financing is collateralized by first mortgages on 14 of EHSI's skilled nursing facilities. EHSI is required to maintain: (1) a consolidated leverage ratio (exclusive of any notes owing to Extencicare REIT and its subsidiaries) of less than 5.5 to 1.0; (2) a consolidated fixed charge ratio of at least 1.5 to 1.0; and (3) minimum consolidated tangible net worth computed by capitalizing net cash flow for the last 12 months. The proceeds from the CMBS financing were used to pay income taxes of \$120.2 million (US\$102.2 million), due in March 2007, associated with the sale of ALC.

Notes to the Unaudited Interim Consolidated Financial Statements

Convertible Subordinated Unsecured Debentures

On June 21, 2007, the REIT completed a public offering of \$115.0 million of 5.70% convertible subordinated unsecured debentures, with a \$19.90 conversion price, due June 30, 2014 (the “2014 Debentures”). Interest is payable semi-annually. The net proceeds from the 2014 Debentures were \$109.3 million, after the payment of issue-related costs of \$5.7 million, of which \$49.4 million (US\$46.0 million) was used to repay the balance outstanding under EHSI’s revolving line of credit. The balance of the net proceeds were partially used to finance the acquisition of Tendercare (Michigan) Inc. and affiliated entities (collectively “Tendercare”) in October 2007, and the remainder will be used to finance other acquisitions, internal growth expenditures, and for other general business purposes. As the 2014 Debentures are convertible into units of the REIT (the “REIT Units”), they are accounted for, in part, as equity. Extencicare REIT determined the fair value of the 2014 Debentures based on the present value of the future cash flows discounted using an effective interest rate of approximately 7.10%. The residual amount of the gross proceeds was allocated to the equity classified conversion option. The REIT has recorded a liability of \$106.3 million and equity of \$8.7 million on the \$115.0 million face value of the debentures. The liability portion is accreted up to the face value of the debentures during the term of the debentures. The issue-related costs of \$5.7 million have been allocated on a pro rata basis and were recorded as a \$0.4 million reduction to the equity component and a \$5.3 million reduction to the liability. The \$5.3 million will be amortized to interest expense using the effective interest rate method over the term of the debentures.

First Series of Commercial Mortgage Backed Securitization (CMBS) Financing

On October 16, 2006, EHSI completed a US\$500.0 million CMBS transaction (the “2011 CMBS Financing”). The 2011 CMBS Financing has a five-year term, with a fixed interest rate of 6.65%, with interest-only monthly payments for the first three years, and principal and interest payments for the last two years, based upon a 25-year amortization period. The 2011 CMBS Financing is collateralized by a first mortgage on 86 of EHSI’s skilled nursing facilities, and all other assets owned by these facilities including personal property and receivables. This series of financing is subject to the same covenant ratios as described under “*Second Series of Commercial Mortgage Backed Securitization (CMBS) Financing*” above.

Revolving Credit Facility

On October 16, 2006, EHSI entered into a new credit facility that provides for borrowings of up to US\$120.0 million, subject to certain limits (the “Credit Facility”). The Credit Facility has a three-year term, no required principal repayments and floating-rate interest based on a pricing grid. This Credit Facility has 24 skilled nursing facilities as specific collateral and is guaranteed by EHI and EHSI’s material domestic subsidiaries. The Credit Facility is secured by certain tangible and intangible assets of EHI, EHSI and the subsidiary guarantors; however it excludes all skilled nursing facilities and associated personal property and accounts receivable that were mortgaged under the CMBS Financing. The Credit Facility also allows EHSI to release facilities from collateralizing the Credit Facility if, after the release, financial covenants will be met and total outstanding borrowings will not exceed the collateral value of the remaining facilities collateralizing the Credit Facility. EHSI is required to comply with various financial covenants and is subject to various mandatory prepayment and commitment reductions.

As of September 30, 2007, EHSI had \$7.5 million (US\$7.5 million) in borrowings under its Credit Facility. The unused portion of the Credit Facility that was available for working capital and corporate purposes, after reduction for outstanding letters of credit of \$17.4 million (US\$17.5 million) was \$69.7 million (US\$70.1 million) as of September 30, 2007.

Deferred Financing Costs

Deferred financing costs included as part of long-term debt at September 30, 2007 were \$21.9 million. The deferred financing costs are valued at amortized cost using the effective interest rate method. Deferred financing costs of \$18.6 million were included in other assets at December 31, 2006 prior to the adoption of CICA Handbook Section 3855. Deferred financing costs increased \$9.6 million in the first nine months of 2007 associated with new debt financing, offset by \$3.6 million amortized to interest expense and a \$2.7 million decrease due to foreign exchange.

Notes to the Unaudited Interim Consolidated Financial Statements

Other

During the third quarter of 2007, the remaining balance of Mortgages and Industrial Development Revenue Bonds were fully repaid.

On June 29, 2007, Extencicare amended its RBC Credit Facility to increase its availability from \$50.0 million to \$70.0 million. The RBC Credit Facility is due on demand, is secured by 14 Canadian nursing homes, and is guaranteed by certain Canadian operating subsidiaries of Extencicare. It is primarily used to back letters of credit, of which there were \$45.1 million issued and outstanding as at September 30, 2007, to secure Extencicare's pension obligations. On July 5, 2007, the additional availability obtained was used to secure \$18.8 million of letters of credit in connection with the sale of Extencicare's investment in Crown Life Insurance Company (*note 8*). The unused portion of this Credit Facility was \$6.1 million as of September 30, 2007.

10. Loss (Gain) on Derivative Financial Instruments and Foreign Exchange

For the third quarter and nine months ended September 30, 2007, the REIT recorded a foreign exchange loss of \$0.2 million and a gain of \$5.3 million, respectively, resulting from the settlement of US dollar denominated notes between EHSI and some of the Canadian-based subsidiaries.

In addition, for the third quarter of 2007, the revaluation of EHSI's foreign currency forward contracts resulted in an unrealized gain of \$3.6 million, and \$15.2 million year to date. One of the contracts locks in EHSI's exchange rate to acquire Canadian dollars at the fixed exchange rate of 1.1141 for US\$4.0 million per month for a 36-month term that commenced in December 2006 and ends in November 2009. In June 2007, EHSI entered into an additional foreign currency forward contract to cover the seven-month period from December 2009 to June 2010. This contract provides for a range of exchange rates on acquiring Canadian dollars for US\$4.0 million each month, with the floor rate set at 1.00, the ceiling rate set at 1.1050, and the current exchange rate applied if it falls between these two rates. In September 2007, EHSI entered into another foreign currency forward contract to acquire US\$76.2 million for \$80.0 million to settle in October 2007.

For the first nine months of 2006, the REIT reported a pre-tax loss of \$16.2 million, of which \$16.6 million was recorded in the third quarter of 2006, related to the valuation of interest rate caps of \$1.0 million, and \$15.2 million on valuation of an interest rate lock agreement in connection with the 2011 CMBS Financing, both of which were settled in October 2006.

11. Unit/Share Capital

Authorized

An unlimited number of REIT Units

An unlimited number of Exchangeable LP Units

Extencicare REIT may issue an unlimited number of trust units, or REIT Units. Each REIT Unit is transferable and represents an equal, 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 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 Class B limited partnership units (the "Exchangeable LP Units") issued by Extencicare Limited Partnership 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 Limited Partnership that are, to the greatest extent practicable, economically equivalent to the distributions made to holders of REIT Units.

During the first nine months of 2007, 1,551,135 Exchangeable LP Units were exchanged for 1,551,135 REIT Units at the option of the holders.

Notes to the Unaudited Interim Consolidated Financial Statements

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 Toronto Stock Exchange for the five trading days immediately preceding the corresponding date of distribution. During the first nine months of 2007, the REIT issued 170,057 REIT Units at a value of \$2.7 million, and Extencicare Limited Partnership issued 15,334 Exchangeable LP Units at a value of \$0.2 million in connection with the DRIP.

Other

Prior to the Arrangement, pursuant to the share provisions, on September 6, 2006, Extencicare issued a notice of redemption to redeem all of its issued and outstanding preferred shares for proceeds of \$25.00 per share and accrued and unpaid dividends, for a total of \$20.2 million. The redemption proceeds represented Extencicare's \$16.7 million carrying value, accrued and unpaid dividends of \$0.2 million and \$3.3 million excess redemption price over the carrying value of the Class II, Preferred Shares, Series 1. On October 12, 2006, the Company deposited with its transfer agent, Computershare Trust Company of Canada, the redemption proceeds. The effective date of the redemption was October 13, 2006, following which any amounts that remain unclaimed for a period of six years shall be forfeited to Extencicare.

During the first nine months of 2006, Extencicare purchased 13,000 Multiple Voting Shares at a cost of \$0.2 million and also purchased 5,700 Class I Preferred Shares, Series 2 at a cost of \$0.1 million pursuant to the purchase obligation provision. In addition, Extencicare issued 570,375 Subordinate Voting Shares on exercise of stock options for proceeds of \$4.7 million, which after adjusting for previously accrued compensation expense, tax credits and contributed surplus, increased capital stock by \$7.0 million.

As a result of these transactions, the carrying value of capital stock decreased by \$9.9 million and retained earnings was charged with \$3.4 million attributable to the cost of purchases in excess of their carrying value of \$0.2 million and the \$3.2 million premium on redemption of preferred shares.

Prior to the Arrangement, for awards under Extencicare's Amended and Restated Subordinate Voting Share Option and Tandem SAR Plan (the "Stock Option Plan"), Extencicare accrued compensation expense on a graded vesting basis in the amount by which the quoted market value of the Subordinate Voting Shares exceeded the option price. Changes in the quoted market value of the Subordinate Voting Shares between the date of grant and the reporting period date result in a change in the measure of compensation for the award. During the nine months ended September 30, 2006, Extencicare accrued \$4.5 million of compensation expense associated with tandem SARs granted.

In August 2006, as part of the Reorganization and pursuant to the terms of the Stock Option Plan, the Board of Directors approved the accelerated vesting of all options under the Stock Option Plan, and any options that remained unexercised after October 25, 2006 were to be cancelled. As a result of this accelerated vesting, Extencicare recognized share-based compensation expense of \$1.0 million during the third quarter of 2006, and classified it as part of the provision for restructuring costs.

12. Earnings per Unit/Share

Basic earnings per unit is calculated using the weighted average number of units outstanding during the period. Prior to the Arrangement, the calculation of earnings per share was based on net earnings reduced by dividends on preferred shares and reflected the quarterly preferential dividend of \$0.025 per share paid to holders of Subordinate Voting Shares. Net earnings remaining after these items were allocated equally to the Subordinate Voting Shares and Multiple Voting Shares.

Diluted earnings per unit/share, 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. In 2007, the after-tax interest on convertible debt has 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 debt, pro-rated for the number of days in the period the convertible debt was outstanding.

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Diluted earnings per unit/share, using the treasury stock method, assumes outstanding stock options are exercised at the beginning of the year and REIT units/common shares are purchased at the average market price during the period from the funds derived on the exercise of these outstanding options. Stock options, when applicable in 2006, with a strike price above the average market price for the period were excluded from the calculation of diluted earnings per unit/share as to include them would have increased earnings per unit/share.

The following table reconciles the numerator and denominator of the basic and diluted earnings (loss) per unit/share computation.

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|---------|-----------------------------------|---------|
| <i>(thousands of dollars unless otherwise noted)</i> | 2007 | 2006 | 2007 | 2006 |
| Numerator for Basic and Diluted Earnings (Loss) per Unit/Share | | | | |
| <i>Net earnings</i> | 16,228 | 1,656 | 59,903 | 13,016 |
| Dividends on preferred shares | – | (216) | – | (617) |
| Net earnings after preferred share dividends | 16,228 | 1,440 | 59,903 | 12,399 |
| Subordinate Voting Share preferential dividend | – | (1,407) | – | (4,212) |
| Total for basic earnings per unit/share | 16,228 | 33 | 59,903 | 8,187 |
| After-tax interest on convertible debt | 1,447 | – | 1,597 | – |
| Dilutive Subordinate Voting Share preferential dividend | – | (14) | – | (60) |
| Total for diluted earnings per unit/share | 17,675 | 19 | 61,500 | 8,127 |
| Earnings (loss) from continuing operations | | | | |
| Total of net earnings for basic earnings (loss) per unit/share | 16,228 | 33 | 59,903 | 8,187 |
| Loss (earnings) from discontinued operations, net of tax | 344 | (2,307) | 3,957 | (5,544) |
| Total from continuing operations for basic earnings (loss) per unit/share | 16,572 | (2,274) | 63,860 | 2,643 |
| After-tax interest on convertible debt | 1,447 | – | 1,597 | – |
| Dilutive Subordinate Voting Share preferential dividend | – | (14) | – | (60) |
| Total from continuing operations for diluted earnings (loss) per unit/share | 18,019 | (2,288) | 65,457 | 2,583 |
| Denominator for Basic and Diluted Earnings (Loss) per Unit/Share (thousands) | | | | |
| Weighted average number of units/shares: | | | | |
| Units | 70,372 | – | 70,311 | – |
| Subordinate Voting Shares | – | 56,246 | – | 56,155 |
| Multiple Voting Shares | – | 11,779 | – | 11,779 |
| Total for basic earnings (loss) per unit/share | 70,372 | 68,025 | 70,311 | 67,934 |
| Units issued if all convertible debt was converted ⁽¹⁾ | 5,779 | – | 2,138 | – |
| Dilutive Subordinate Voting Share stock options ⁽²⁾ | – | 587 | – | 802 |
| Total for diluted earnings (loss) per unit/share | 76,151 | 68,612 | 72,449 | 68,736 |
| Basic and Diluted Earnings per Unit/Share (dollars) ^{(2) (3)} | | | | |
| Net earnings | | | | |
| REIT/Exchangeable LP, Subordinate Voting Multiple Voting | 0.23 | 0.02 | 0.85 | 0.19 |
| | | – | | 0.12 |
| Earnings (loss) from continuing operations | | | | |
| REIT/Exchangeable LP, Subordinate Voting Multiple Voting | 0.23 | (0.01) | 0.90 | 0.11 |
| | | (0.03) | | 0.04 |

⁽¹⁾ Pro-rated for the 101 days in the nine months ended September 30, 2007 the convertible debt was outstanding.

⁽²⁾ For the nine months ended September 30, 2006, there were no stock options excluded from the calculation of dilutive stock options.

⁽³⁾ After giving effect to the Subordinate Voting Share preferential dividend of \$0.075 per share in the nine months ended September 30, 2006.

13. Commitments and Contingencies

Acquisitions

In August 2007, EHSI entered into an agreement to purchase a skilled nursing facility (60 beds) and an assisted living facility (62 units) in Wausau, Wisconsin for cash consideration of US\$15.7 million. EHSI expects to close the transaction on December 1, 2007.

Property and Equipment Commitments

As of September 30, 2007, EHSI's outstanding capital expenditure purchase commitments totalled US\$18.6 million. Included in EHSI's outstanding commitments was US\$4.1 million related to construction projects in progress, representing 121 nursing home beds, of which 110 beds will be completed at the end of 2007, and the remainder by April 2008. The projects are comprised of a 100-bed nursing facility in Washington and a 21-bed nursing home addition in Ohio. The total estimated cost of these projects is US\$14.1 million, of which US\$8.3 million had been incurred through to September 30, 2007.

Contingent Liabilities

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

14. Segmented Information

| | Three months ended | | Nine months ended | |
|---|--------------------|---------|-------------------|----------------|
| | September 30 | | September 30 | |
| (thousands of dollars) | 2007 | 2006 | 2007 | 2006 |
| Revenue | | | | |
| United States | 291,654 | 296,390 | 913,899 | 875,966 |
| Canada | 142,368 | 137,614 | 420,873 | 404,691 |
| | 434,022 | 434,004 | 1,334,772 | 1,280,657 |
| EBITDA ⁽¹⁾ | | | | |
| United States | 36,157 | 34,677 | 117,583 | 104,764 |
| Canada | 15,246 | 13,308 | 40,487 | 33,400 |
| | 51,403 | 47,985 | 158,070 | 138,164 |
| Earnings (Loss) from Continuing Health Care Operations | | | | |
| United States | 12,102 | (306) | 47,085 | 3,613 |
| Canada | 4,470 | (1,584) | 15,234 | 167 |
| | 16,572 | (1,890) | 62,319 | 3,780 |
| | | | Sept. 30 | Dec. 31 |
| (thousands of dollars) | | | 2007 | 2006 |
| Goodwill | | | | |
| United States ⁽²⁾ | | | 70,921 | 80,220 |
| Canada | | | 43 | 43 |
| | | | 70,964 | 80,263 |
| Health Care Assets | | | | |
| United States | | | 834,760 | 894,928 |
| Canada | | | 442,733 | 340,863 |
| | | | 1,277,493 | 1,235,791 |
| Equity accounted investments | | | | |
| | | | – | 79,391 |
| Total consolidated assets | | | 1,277,493 | 1,315,182 |

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

(2) The change in goodwill is due to \$2.8 million pertaining to acquisitions in the first nine months, partly offset by \$12.1 million for foreign currency translation of U.S. operations.

15. Employee Future Benefits

The future benefit expense of Extencicare's defined benefit pension plans for each of the three-month periods ended September 30, 2007 and 2006 was \$0.6 million and \$0.9 million, respectively. For each of the nine months ended September 30, 2007 and 2006, the future benefit expense was \$1.7 million and \$2.8 million, respectively.

16. Subsequent Events

Acquisitions

On October 31, 2007, EHSI completed the acquisition of Tendercare in accordance with the previously announced May 9, 2007, purchase and sale agreement. The Tendercare portfolio acquired is comprised of 30 senior care facilities (approximately 3,300 operational beds), in the State of Michigan, which includes 29 skilled nursing facilities and one inpatient rehabilitation hospital. As well, Tendercare currently has two skilled nursing facilities under development (177 beds), one of which is expected to be completed by the end of 2007, and the other in the third quarter of 2008. In addition, EHSI will manage an assisted living facility (51 units), which will continue to be owned by the former shareholders of Tendercare.

Total consideration for the transaction was US\$232.3 million (excluding transaction costs). The consideration includes the assumption of existing debt of US\$76.6 million, the issuance of US\$26.4 million of 7.5% seller notes, and US\$129.3 million in cash. The debt assumed includes US\$27.4 million in U.S. Department of Housing and Urban Development (HUD) secured debt with maturity dates ranging from August 2018 to July 2032, and a term loan and credit facility with a maturity date of April 2008. With the exception of subsidiaries of Tendercare with the HUD financed debt, Tendercare and its subsidiaries will be unrestricted subsidiaries of the existing EHSI Credit Facility. The weighted average interest rate on the debt assumed is 6.85%. Seller notes of US\$16.0 million are payable commencing on the third anniversary date at US\$4.0 million per annum until maturity in 2013; whereas the balance of the notes of US\$10.4 million is payable based upon certain factors being met, but have a term of no longer than 18 months.

The acquisition will be accounted for as a purchase transaction. In the following table, Extencicare REIT has estimated the impact of the acquisition and the allocation of the purchase price as of October 31, 2007. These figures will be finalized in 2008.

| <i>(thousands of dollars)</i> | US\$ | C\$ |
|--|----------------|----------------|
| Cash | 20,539 | |
| Current assets | 33,317 | |
| Property and equipment | 135,479 | |
| Goodwill and other intangible assets | 94,135 | |
| Other long-term assets | 1,532 | |
| Total assets | 285,002 | |
| Current liabilities | 21,856 | |
| Long-term debt, at fair value with imputed interest rate of 6% | 75,178 | |
| Future income tax liability | 29,352 | |
| Other long-term liabilities | 265 | |
| Net assets purchased | 158,351 | 157,528 |
| <i>(thousands of dollars)</i> | US\$ | C\$ |
| Cash, including estimated transaction costs | 131,951 | |
| Seller notes | 26,400 | |
| Consideration | 158,351 | 157,528 |

Disposals

EHSI leased 12 nursing properties in Texas from Triple S Investment Company (Triple S) that were subleased to Senior Health Properties – Texas, Inc. (Senior Health – Texas), along with the four Texas properties that EHSI owned. EHSI had made guarantees to Triple S for the payment of operating leases by Senior Health – Texas. In December 2006, EHSI made the decision, in conjunction with Triple S, to dispose of these facilities. On November 2, 2007, EHSI and Triple S completed the sale of all 16 Texas properties to an unrelated party, thereby terminating EHSI's obligations under its lease agreement with Triple S. The net proceeds from the sale of EHSI's four properties approximate their \$7.0 million (US\$7.0 million) carrying value, which are reported as assets held for sale (*note 6*).

EXTENDICARE

| Facility Location and Resident Capacity | | | | | | | | |
|--|---------------------------------|------------------------------|---|------------------------------|---------------------------------|------------------------------|---------------------------------|------------------------------|
| <i>Pro forma* as at September 30, 2007</i> | Nursing Centres | | Assisted Living and Retirement Centres | | Chronic Care Units | | Total | |
| By State/Province | Number of Facilities | Resident Capacity | Number of Facilities | Resident Capacity | Number of Facilities | Resident Capacity | Number of Facilities | Resident Capacity |
| United States | | | | | | | | |
| Pennsylvania | 28 | 3,438 | 6 | 247 | – | – | 34 | 3,685 |
| Michigan * | 29 | 3,265 | 1 | 51 | 1 | 25 | 31 | 3,341 |
| Ohio | 28 | 2,861 | – | 30 | – | – | 28 | 2,891 |
| Wisconsin | 25 | 2,139 | 1 | 73 | – | – | 26 | 2,212 |
| Indiana | 19 | 1,866 | – | 35 | – | – | 19 | 1,901 |
| Kentucky | 21 | 1,822 | – | – | – | – | 21 | 1,822 |
| Washington | 15 | 1,604 | 1 | 47 | – | – | 16 | 1,651 |
| Minnesota | 8 | 1,039 | – | – | – | – | 8 | 1,039 |
| Idaho | 2 | 194 | – | – | – | – | 2 | 194 |
| Oregon | 2 | 169 | – | – | – | – | 2 | 169 |
| Delaware | 1 | 120 | – | – | – | – | 1 | 120 |
| West Virginia | 1 | 120 | – | – | – | – | 1 | 120 |
| Total United States | 179 | 18,637 | 9 | 483 | 1 | 25 | 189 | 19,145 |
| Canada | | | | | | | | |
| Ontario | 53 | 7,911 | 1 | 493 | 1 | 120 | 55 | 8,524 |
| Alberta | 13 | 1,137 | – | – | – | – | 13 | 1,137 |
| Saskatchewan | 5 | 654 | – | – | – | – | 5 | 654 |
| Manitoba | 5 | 762 | – | – | – | – | 5 | 762 |
| Total Canada | 76 | 10,464 | 1 | 493 | 1 | 120 | 78 | 11,077 |
| TOTAL | 255 | 29,101 | 10 | 976 | 2 | 145 | 267 | 30,222 |
| By Type of Ownership | | | | | | | | |
| United States | | | | | | | | |
| Owned | 165 | 17,060 | 3 | 277 | 1 | 25 | 169 | 17,362 |
| Leased | 7 | 764 | – | – | – | – | 7 | 764 |
| Managed | 7 | 813 | 6 | 206 | – | – | 13 | 1,019 |
| Total United States | 179 | 18,637 | 9 | 483 | 1 | 25 | 189 | 19,145 |
| Canada | | | | | | | | |
| Owned | 45 | 6,083 | – | – | – | – | 45 | 6,083 |
| Leased | 9 | 1,155 | – | 76 | – | – | 9 | 1,231 |
| Managed | 22 | 3,226 | 1 | 417 | 1 | 120 | 24 | 3,763 |
| Total Canada | 76 | 10,464 | 1 | 493 | 1 | 120 | 78 | 11,077 |
| TOTAL | 255 | 29,101 | 10 | 976 | 2 | 145 | 267 | 30,222 |

* Pro forma for the acquisition of Tendercare (Michigan) Inc. and affiliate entities on October 31, 2007, comprised of 31 facilities in the State of Michigan (note 16)

Unitholder Information

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Toronto Stock Exchange – EXE.UN

Transfer Agent

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Published Information

Extendicare REIT's 2006 Annual Report is available for viewing or printing on its website, in addition to news releases, quarterly reports and other filings with the securities commissions.

Printed copies are available upon request to the Secretary.

Visit Extendicare's website @ www.extendicare.com

