

Brookdale Senior Living Inc.
Form 10-K
March 02, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 001-32641

BROOKDALE SENIOR LIVING INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

20-3068069
(I.R.S. Employer
Identification No.)

111 Westwood Place, Suite 200
Brentwood, Tennessee 37027
(Address of Principal Executive Offices)

(Registrant's telephone number
including area code)

(615) 221-2250

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of Each Class	Name of Each Exchange on Which
Common Stock, \$0.01 Par Value Per Share	Registered New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

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None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated
filer

Non-accelerated filer (Do not check
if a smaller reporting company)

Smaller reporting
company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes [] No [X]

The aggregate market value of common stock held by non-affiliates of the registrant on June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$761.1 million. The market value calculation was determined using a per share price of \$20.36, the price at which the registrant's common stock was last sold on the New York Stock Exchange on such date. For purposes of this calculation, shares held by non-affiliates excludes only those shares beneficially owned by the registrant's executive officers, directors, and stockholders owning 10% or more of the outstanding common stock (and, in each case, their immediate family members and affiliates).

As of February 23, 2009, 101,722,806 shares of the registrant's common stock, \$0.01 par value, were outstanding (excluding unvested restricted shares).

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of the registrant's Definitive Proxy Statement relating to its 2009 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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FORM 10-K

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SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements in this Annual Report on Form 10-K and other information we provide from time to time may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Those forward-looking statements include all statements that are not historical statements of fact and those regarding our intent, belief or expectations, including, but not limited to, statements relating to our operational initiatives and our expectations regarding their effect on our results; our expectations regarding occupancy, revenue, expense levels, the demand for senior housing, acquisition opportunities and asset dispositions; our belief regarding our growth prospects; our ability to secure financing or replace or extend existing debt as it matures; our ability to remain in compliance with all of our debt and lease agreements (including the financial covenants contained therein); our expectations regarding liquidity; our expectations regarding financings and refinancings of assets; our plans to generate growth organically through occupancy improvements, increases in annual rental rates and the achievement of operating efficiencies and cost savings; our plans to expand our offering of ancillary services (therapy and home health); our plans to expand existing communities; the expected project costs for our expansion program; our expected levels of expenditures and reimbursements (and the timing thereof); the anticipated cost and expense associated with the resolution of pending litigation and our expectations regarding the disposition thereof; our expectations for the performance of our entrance fee communities; our ability to anticipate, manage and address industry trends and their effect on our business; our expectations regarding the payment of dividends; and our ability to increase revenues, earnings, Adjusted EBITDA, Cash From Facility Operations, and/or Facility Operating Income (as such terms are defined herein). Words such as “anticipate(s)”, “expect(s)”, “intend(s)”, “plan(s)”, “target(s)”, “project(s)”, “predict(s)”, “believe(s)”, “may”, “will”, “would”, “could”, “should”, “seek(s)”, “estimate(s)” and similar expressions are intended to identify such forward-looking statements. These statements are based on management’s current expectations and beliefs and are subject to a number of risks and uncertainties that could lead to actual results differing materially from those projected, forecasted or expected. Although we believe that the assumptions underlying the forward-looking statements are reasonable, we can give no assurance that our expectations will be attained. Factors which could have a material adverse effect on our operations and future prospects or which could cause actual results to differ materially from our expectations include, but are not limited to, the risk associated with the current global economic crisis and its impact upon capital markets and liquidity; our inability to extend (or refinance) debt as it matures or replace our amended credit facility when it matures; the risk that we may not be able to satisfy the conditions precedent to exercising the extension options associated with certain of our debt agreements; events which adversely affect the ability of seniors to afford our monthly resident fees or entrance fees; the conditions of housing markets in certain geographic areas; our ability to generate sufficient cash flow to cover required interest and long-term operating lease payments; the effect of our indebtedness and long-term operating leases on our liquidity; the risk of loss of property pursuant to our mortgage debt and long-term lease obligations; the possibilities that changes in the capital markets, including changes in interest rates and/or credit spreads, or other factors could make financing more expensive or unavailable to us; the risk that we may be required to post additional cash collateral in connection with our interest rate swaps; the risk that continued market deterioration could jeopardize certain of our counterparties’ obligations; changes in governmental reimbursement programs; our limited operating history on a combined basis; our ability to effectively manage our growth; our ability to maintain consistent quality control; delays in obtaining regulatory approvals; our ability to integrate acquisitions into our operations; competition for the acquisition of assets; our ability to obtain additional capital on terms acceptable to us; a decrease in the overall demand for senior housing; our vulnerability to economic downturns; acts of nature in certain geographic areas; terminations of our resident agreements and vacancies in the living spaces we lease; increased competition for skilled personnel; increased union activity; departure of our key officers; increases in market interest rates; environmental contamination at any of our facilities; failure to comply with existing environmental laws; an adverse determination or resolution of complaints filed against us; the cost and difficulty of complying with increasing and evolving regulation; and other risks detailed from time to time in our filings with the Securities and Exchange Commission, press releases and other communications, including those set forth under “Risk Factors” included elsewhere in this Annual Report on Form

10-K. Such forward-looking statements speak only as of the date of this Annual Report. We expressly disclaim any obligation to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or change in events, conditions or circumstances on which any statement is based.

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PART I

Item 1. Business.

Overview

As of December 31, 2008, we are the largest operator of senior living communities in the United States based on total capacity, with 548 communities in 35 states and the ability to serve over 51,800 residents. We offer our residents access to a full continuum of services across the most attractive sectors of the senior living industry. As of December 31, 2008, we operated in four business segments: retirement centers, assisted living, continuing care retirement communities (“CCRCs”) and management services.

As of December 31, 2008, we operated 85 retirement center communities with 15,251 units/beds, 409 assisted living communities with 21,021 units/beds, 32 CCRCs with 11,183 units/beds and 22 communities with 4,349 units/beds where we provide management services for third parties. The majority of our units/beds are located in campus settings or communities containing multiple services, including CCRCs. As of December 31, 2008, our communities were 89.5% occupied. We generate approximately 86.2% of our revenues from private pay customers. For the year ended December 31, 2008, 39.5% of our revenues were generated from owned communities, 60.1% from leased communities and 0.4% from management fees from communities we operate on behalf of third parties.

The table below presents a summary of our operating results and certain other financial metrics for each of the years ended December 31, 2008, 2007 and 2006 (dollars in millions, except dividends per share):

	For the Years Ended December 31,		
	2008	2007	2006
Total revenues	\$ 1,928.1	\$ 1,839.3	\$ 1,309.9
Net loss(1)	\$ (373.2)	\$ (162.0)	\$ (108.1)
Adjusted EBITDA(2)	\$ 302.6	\$ 306.4	\$ 200.6
Cash From Facility Operations(3)	\$ 130.1	\$ 143.2	\$ 88.7
Facility Operating Income(2)	\$ 637.5	\$ 642.3	\$ 476.3
Dividends declared per share of common stock	\$ 0.75	\$ 1.95	\$ 1.55

(1) Net loss for 2008 includes non-cash impairment charges of \$220.0 million.

(2) Adjusted EBITDA and Facility Operating Income are non-GAAP financial measures we use in evaluating our operating performance. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Non-GAAP Financial Measures” for an explanation of how we define each of these measures, a detailed description of why we believe such measures are useful and the limitations of each measure, and a reconciliation of net loss to each of these measures.

(3) Cash From Facility Operations is a non-GAAP financial measure we use in evaluating our liquidity. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Non-GAAP Financial Measures” for an explanation of how we define this measure, a detailed description of why we believe such measure is useful and the limitations of such measure, and a reconciliation of net cash provided by operating activities to such measure. In the first quarter of 2008 we changed our definition of Cash From Facility Operations to include lease financing debt amortization with fair market value or no purchase options. Prior periods have been restated

for comparative purposes.

During 2008, our operating results were favorably impacted by an increase in our total revenues and average monthly revenue per unit/bed across all segments. Although we made progress in certain areas of our business, our recent operating results have been negatively impacted by unfavorable conditions in the housing, credit and financial markets and by deteriorating conditions in the overall economy, resulting in lower than anticipated occupancy rates and increased levels of expenses. In response to these conditions, we are focusing on maintaining occupancy, increasing our ancillary services programs, and controlling expenses (including by limiting our capital expenditures).

We are also taking steps to preserve our liquidity and increase our financial flexibility during 2009. For example, we have suspended our quarterly dividend payments and have terminated our share repurchase program. As

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discussed in more detail elsewhere in the Annual Report on Form 10-K, we also recently entered into an amended credit facility with Bank of America, N.A., as administrative agent, providing for a \$230.0 million revolving credit facility that matures on August 31, 2010. Furthermore, we have extended the maturity of a number of mortgage loans, and, after giving effect to contractual extension options, will have virtually no mortgage debt maturities until 2011. Finally, we have taken steps to reduce materially our exposure to collateralization requirements associated with interest rate swaps.

In the fourth quarter of 2008, similar to many companies, we experienced a significant decline in the market value of our common stock due primarily to the depressed macroeconomic environment and volatility in the equity markets. As a result, our market capitalization eroded in the fourth quarter when compared to previous periods and was significantly below book value. In accordance with the requirements of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (“SFAS 142”), we performed an impairment test of the goodwill for each of our reporting units as of the end of the fourth quarter. As a result of our impairment tests, we recorded a non-cash goodwill impairment charge of \$215.0 million for the quarter ended December 31, 2008. The non-cash charge does not impact our ongoing business operations, liquidity, cash flows from operating activities or financial covenants and will not result in any future cash expenditure. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” for additional information regarding the impairment charge.

We believe that we are positioned to take advantage of favorable demographic trends and future supply-demand dynamics in the senior living industry. We also believe that we operate in the most attractive sectors of the senior living industry with significant opportunities to increase our revenues through providing a combination of housing, hospitality services, ancillary services and health care services. Our senior living communities offer residents a supportive “home-like” setting, assistance with activities of daily living, or ADLs, and, in several communities, licensed skilled nursing services. We also provide ancillary services, including therapy and home health services, to our residents. By providing residents with a range of service options as their needs change, we provide greater continuity of care, enabling seniors to “age-in-place” and thereby maintain residency with us for a longer period of time. The ability of residents to age-in-place is also beneficial to our residents and their families who are concerned with care decisions for their elderly relatives.

We believe that there are substantial organic growth opportunities inherent in our existing portfolio. We intend to take advantage of those opportunities by growing revenues, while tightening expense control, at our existing communities, driving our ancillary services business across our existing portfolio and, to a lesser extent, expanding our existing communities.

Growth Strategy

Our primary growth objectives are to grow our revenues, Adjusted EBITDA, Cash From Facility Operations and Facility Operating Income. Key elements of our strategy to achieve these objectives include:

- Organic growth in our core business, including expense control and the realization of economies of scale. We plan to grow our existing operations by increasing revenues through a combination of occupancy growth and monthly service fee increases as a result of our competitive strength and growing demand for senior living communities. In addition, we intend to take advantage of our sophisticated operating and marketing expertise to retain existing residents and attract new residents to our communities. We also plan to continue our efforts to achieve cost savings through the realization of additional economies of scale. The size of our business has allowed us to achieve savings in the procurement of goods and services and increased efficiencies with respect to various corporate functions, and we expect that we can achieve additional savings and efficiencies.

- Growth through the continued expansion of our ancillary services programs (including therapy services and home health). We plan to grow our revenues by further expanding our Innovative Senior Care program throughout our retirement centers, assisted living, CCRCs and management services segments. This expansion includes both continuing to roll out our services to communities not currently serviced as well as expanding the scope of services provided at the communities currently served. Through the Innovative Senior Care program, we currently provide therapy, home health and other ancillary services, as well as education and wellness programs, to residents of many of our communities. These programs are focused on wellness and physical fitness to allow residents to maintain maximum

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independence. These services provide many continuing education opportunities for residents and their families through health fairs, seminars, and other consultative interactions. The therapy services we provide include physical, occupational, speech and other specialized therapy and home health services. The home health services we provide include skilled nursing, physical therapy, occupational therapy, speech language pathology, home health aide services as well as social services as needed. In addition to providing these in-house therapy and wellness services at our communities, we also provide these services to other senior living communities that we do not own or operate. These services may be reimbursed under the Medicare program or paid directly by residents from private pay sources and revenues are recognized as services are provided. We believe that our Innovative Senior Care program is unique in the senior living industry and that we have a significant advantage over our competitors with respect to providing ancillary services because of our established infrastructure and experience. We believe there is a significant opportunity to grow our revenues by continuing to expand these services to communities at which they are not presently offered, which we believe will increase our revenue per unit/bed in the future. As of December 31, 2008 we offered therapy services in our communities containing 35,049 units and home health in our communities containing 16,730 units.

- Growth through the expansion of existing communities. We intend to grow our revenues and cash flows through the expansion of certain of our existing communities where economically advantageous. Certain of our communities with stabilized occupancies and excess demand in their respective markets may benefit from additions and expansions (which additions and expansions may be subject to landlord, lender and other third party consents) offering increased capacity. Additionally, the community, as well as our presence in the market, may benefit from adding a new level of service for residents.

Given the current market environment, the stressed credit environment and limitations imposed by our new line of credit, we are focusing on integrating previous acquisitions and on the significant organic growth opportunities inherent in our growth strategy. Over the longer-term, we plan to take advantage of the fragmented continuing care, independent living and assisted living sectors by selectively purchasing existing operating companies and communities. Additionally, as opportunities arise, we may also grow through the selective acquisition and consolidation of additional communities, asset portfolios and other senior living companies, as well as through the acquisition of the fee interest in communities that we currently lease or manage. Our acquisition strategy will continue to focus primarily on communities where we can improve service delivery, occupancy rates and cash flow.

The Senior Living Industry

The senior living industry is highly fragmented and characterized by numerous local and regional operators. We are one of a limited number of national operators that provide a broad range of community locations and service level offerings at varying price levels. The industry has seen significant growth in recent years and has been marked by the emergence of the assisted living segment in the mid-1990's.

Since the beginning of 2007, the industry has been affected by the downturn in the housing market and by the declining economy in general. In spite of these factors, occupancy in the industry has only decreased by 340 basis points for the independent living industry and 220 basis points for the assisted living industry since that time according to the National Investment Center for the Seniors Housing & Care Industry. Construction of new senior housing units, which, according to The American Seniors Housing Association, peaked at more than 62,064 units in 1999, has now moderated to a projected 14,000 units annually for 2009 and is projected to decrease further in the next several years.

Despite current economic conditions, we believe that a number of trends will contribute to the continued growth of the senior living industry in coming years. The primary market for senior living services is individuals age 70 and

older. According to U.S. Census data, the group is expected to grow by 4.1 million through 2015. As a result of these demographic trends, we expect an increase in the demand for senior living services in future years.

We believe the senior living industry has been and will continue to be impacted by several other trends. The use of long-term care insurance is increasing among current and future seniors as a means of planning for the costs of senior living services. In addition, as a result of increased mobility in society, reduction of average family size and increased number of two-wage earner couples, more seniors are looking for alternatives outside of their family for their care. Growing consumer awareness among seniors and their families concerning the types of

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services provided by independent and assisted living operators has further contributed to the opportunities in the senior living industry. Also, seniors currently possess greater financial resources than in the past, which makes it more likely that they are able to afford to live in market-rate senior housing. Seniors in the geographic areas in which we operate tend to have a significant amount of assets generated from savings, pensions and, despite weakening in national housing markets, equity from the sale of private homes.

Challenges in our industry include increased state and local regulation of the assisted living and skilled nursing industries, which has led to an increase in the cost of doing business. The regulatory environment continues to intensify in the number and types of laws and regulations affecting us, accompanied by increased enforcement activity by state and local officials. In addition, like other companies, our financial results may be negatively impacted by increasing employment costs including salaries, wages and benefits, such as health care, for our employees. Increases in the costs of utilities, insurance, and real estate taxes may also have a negative impact on our financial results.

Certain per person annual limits on Medicare reimbursement for therapy services became effective in 2006, subject to certain exceptions. These exceptions are currently scheduled to expire on December 31, 2009. If these exceptions are modified or not extended beyond that date, there may be reductions in our therapy services revenue and the profitability of those services. There continues to be various federal and state legislative and regulatory proposals to implement cost containment measures that would limit payments to healthcare providers in the future. Changes in the reimbursement policies of the Medicare and Medicaid programs could have an adverse effect on our results of operations and cash flow.

Our History

We were formed as a Delaware corporation in June 2005 for the purpose of combining two leading senior living operating companies, Brookdale Living Communities, Inc., or BLC, and Alterra Healthcare Corporation, or Alterra. BLC and Alterra had been operating independently since 1986 and 1981, respectively. Beginning in December 2003, BLC and Alterra were under the common control of Fortress Investment Group LLC (“Fortress” or “FIG”). On November 22, 2005, we completed our initial public offering of common stock, and on July 25, 2006, we acquired American Retirement Corporation, or ARC, another leading senior living provider which had been operating independently since 1978. Funds managed by affiliates of Fortress beneficially own 60,875,826 shares, or approximately 57.8% of our outstanding common stock (including unvested restricted shares), as of December 31, 2008.

Our Product Offerings

We offer a variety of senior living housing and service alternatives in communities located across the United States. Our primary product offerings consist of (i) retirement center communities; (ii) assisted living communities; and (iii) CCRCs. As discussed below under “Segments”, we also operate certain communities on behalf of third parties pursuant to management agreements.

Retirement centers. Our retirement center communities are primarily designed for middle to upper income seniors generally age 70 and older who desire an upscale residential environment providing the highest quality of service.

The majority of our retirement center communities consist of both independent and assisted living units in a single community, which allows residents to “age-in-place” by providing them with a continuum of senior independent and assisted living services. While the number varies depending upon the particular community, approximately 77.8% of all of the units at our retirement center communities are independent living units, with the balance of units licensed for assisted living.

Our retirement center communities are large multi-story buildings containing on average 184 units/beds with extensive common areas and amenities. Residents may choose from studio, one-bedroom and two-bedroom units, depending upon the specific community.

Each retirement center community provides residents with basic services such as meal service, 24-hour emergency response, housekeeping, concierge services, transportation and recreational activities. Most of these communities also offer custom tailored supplemental care services at an additional charge, which may include

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medication reminders, check-in services and escort and companion services. In addition, our Innovative Senior Care program is currently available in most of our retirement centers communities. Through the program, we are able to offer our residents various education, wellness, therapy, home health and other ancillary services.

In addition to the basic services, our retirement center communities that include assisted living also provide residents with supplemental care service options to provide assistance with ADLs. The levels of care provided to residents vary from community to community depending, among other things, upon the licensing requirements of the state in which the community is located.

Residents in our retirement center communities are able to maintain their residency for an extended period of time due to the range of service options available to residents (not including skilled nursing) as their needs change. Residents with cognitive or physical frailties and higher level service needs are accommodated with supplemental services in their own units or, in certain communities, are cared for in a more structured and supervised environment on a separate wing or floor. These communities also generally have a dedicated assisted living staff, including nurses at the majority of communities, and separate assisted living dining rooms and activity areas.

Our retirement center communities represent approximately 29.4% of our total senior living capacity.

Assisted Living. Our assisted living communities offer housing and 24-hour assistance with ADLs to mid-acuity frail and elderly residents.

Our assisted living communities include both freestanding, multi-story communities with more than 30 beds and smaller, freestanding single story communities with less than 30 beds. Depending upon the specific location, the community may include (i) private studio, one-bedroom and one-bedroom deluxe apartments, or (ii) individual rooms for one or two residents in wings or “neighborhoods” scaled to a single-family home, which includes a living room, dining room, patio or enclosed porch, laundry room and personal care area, as well as a caregiver work station.

Under our Clare Bridge brand, we also operate 75 memory care communities, which are freestanding assisted living communities specially designed for residents with Alzheimer’s disease and other dementias requiring the attention, personal care and services needed to help cognitively impaired residents maintain a higher quality of life. Our memory care communities have from 20 to 60 beds and some are part of a campus setting, which includes a freestanding assisted living community.

All residents at our assisted living and memory care communities receive the basic care level, which includes ongoing health assessments, three meals per day and snacks, coordination of special diets planned by a registered dietitian, assistance with coordination of physician care, social and recreational activities, housekeeping and personal laundry services. In some locations we offer our residents exercise programs and programs designed to address issues associated with early stages of Alzheimer’s and other forms of dementia. In addition, we offer at additional cost higher levels of personal care services to residents at these communities who are very physically frail or experiencing early stages of Alzheimer’s disease or other dementia and who require more frequent or intensive physical assistance or increased personal care and supervision due to cognitive impairments. We also offer our Innovative Senior Care program at certain of our assisted living and memory care communities.

As a result of their progressive decline in cognitive abilities, residents at our memory care communities typically require higher levels of personal care and services and therefore pay higher monthly service fees. Specialized services include assistance with ADLs, behavior management and an activities program, the goal of which is to provide a normalized environment that supports residents’ remaining functional abilities. Whenever possible, residents participate in all facets of daily life at the residence, such as assisting with meals, laundry and housekeeping.

Our assisted living communities (including our memory care communities) represent approximately 40.6% of our total senior living capacity.

CCRCs. Our CCRCs are large communities that offer a variety of living arrangements and services to accommodate all levels of physical ability and health. Most of our CCRCs have retirement centers, assisted living and skilled nursing available on one campus, and some also include memory care/Alzheimer's units.

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Ten of our CCRCs are entry fee communities, in which residents in the retirement centers apartment units pay a one-time upfront entrance fee, typically \$100,000 to \$400,000 or more, which fee is partially refundable in certain circumstances. The amount of the entrance fee varies depending upon the type and size of the dwelling unit, the type of contract plan selected, whether the contract contains a lifecare benefit (i.e., a healthcare discount) for the resident, the amount and timing of refund, and other variables. These agreements are subject to regulations in various states. In addition to their initial entrance fee, residents under all of our entrance fee agreements also pay a monthly service fee, which entitles them to the use of certain amenities and services. Since we receive entrance fees upon initial occupancy, the monthly fees are generally less than fees at a comparable rental community.

The refundable portion of a resident's entrance fee is generally refundable within a certain number of months or days following contract termination or upon the sale of the unit, or in certain agreements, upon the resale of a comparable unit or 12 months after the resident vacates the unit. In addition, certain entrance fee agreements entitle the resident to a refund of the original entrance fee paid plus a percentage of the appreciation of the unit upon resale.

We also offer a broad array of ancillary services, including therapy, home health, and other services through our Innovative Senior Care program, to the residents of each of our CCRCs.

Our CCRCs represent approximately 21.6% of our total senior living capacity. The retirement centers units at our entry fee communities (those units on which entry fees are paid) represent 11.1% of our total senior living capacity. Excluding managed communities and equity homes (which are residences located on certain of our CCRC campuses that we do not generally own), entry fee communities represent 9.2% of our total senior living capacity.

Competitive Strengths

We believe our nationwide network of senior living communities is well positioned to benefit from the growth and increasing demand in the industry. Some of our most significant competitive strengths are:

- Skilled management team with extensive experience. Our senior management team has extensive experience in acquiring, operating and managing a broad range of senior living assets, including experience in the senior living, healthcare, hospitality and real estate industries.
- Geographically diverse, high-quality, purpose-built communities. As of December 31, 2008, we operate a nationwide base of 548 purpose-built communities in 35 states, including 88 communities in nine of the top ten standard metropolitan statistical areas.
- Ability to provide a broad spectrum of care. Given our diverse mix of independent and assisted living communities and CCRCs, we are able to meet a wide range of our customers' needs. We believe that we are one of the few companies in the senior living industry with this capability. We believe that our multiple product offerings create marketing synergies and cross-selling opportunities.
- The size of our business allows us to realize cost and operating efficiencies. We are the largest operator of senior living communities in the United States based on total capacity. The size of our business allows us to realize cost savings and economies of scale in the procurement of goods and services. Our scale also allows us to achieve increased efficiencies with respect to various corporate functions. We intend to utilize our expertise and size to capitalize on economies of scale resulting from our national platform. Our geographic footprint and centralized infrastructure provide us with a significant operational advantage over local and regional operators of senior living communities. In connection with our formation transactions and our acquisitions, we negotiated new contracts for food, insurance and other goods and services. In addition, we have and will continue to consolidate corporate

functions such as accounting, finance, human resources, legal, information technology and marketing. We began to realize these savings upon the completion of our formation transactions in September 2005 and have realized additional savings as we continued to consolidate and integrate various corporate functions.

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- Significant experience in providing ancillary services. Through our Innovative Senior Care program, we provide a range of education, wellness, therapy, home health and other ancillary services to residents of certain of our retirement centers, assisted living, and CCRC communities. Having therapy clinics and home health agencies located in our buildings to provide needed services to our residents is a distinctive competitive difference. We have significant experience in providing these ancillary services and expect to receive additional revenues as we expand our ancillary service offerings to additional communities.

Segments

As of December 31, 2008, we had four reportable segments: retirement centers; assisted living; CCRCs; and management services. These segments were determined based on the way that our chief operating decision makers organize our business activities for making operating decisions and assessing performance.

Our management services segment includes the results of communities that we operate on behalf of third parties pursuant to management agreements. Information regarding the other segments is included above under “Our Product Offerings”.

Operating results from our four business segments are discussed further in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 22 to our consolidated financial statements included herein.

Operations

Operations Overview

We believe that successful senior living operators must effectively combine the expertise and business disciplines of housing, hospitality, health care, marketing, finance and real estate.

We continually review opportunities to expand the types of services we provide to our residents. To date, we have been able to increase our monthly revenue per unit each year and we have generally experienced increasing facility operating margins through a combination of the implementation of efficient operating procedures and the economies of scale associated with the size and number of our communities. Our operating procedures include securing national vendor contracts to obtain the lowest possible pricing for certain services such as food, energy and insurance, implementing effective budgeting and financial controls at each community, and establishing standardized training and operations procedures.

We have implemented intensive standards, policies and procedures and systems, including detailed staff manuals, which we believe have contributed to high levels of customer service and to improved facility operating margins. We have centralized accounting controls, finance and other operating functions in our support centers so that, consistent with our operating philosophy, community-based personnel can focus on resident care and efficient operations. We have established company-wide policies and procedures relating to, among other things: resident care; community design and community operations; billings and collections; accounts payable; finance and accounting; risk management; development of employee training materials and programs; marketing activities; the hiring and training of management and other community-based personnel; compliance with applicable local and state regulatory requirements; and implementation of our acquisition, development and leasing plans.

Consolidated Corporate Operations Support

We have developed a centralized infrastructure and services platform, which provides us with a significant operational advantage over local and regional operators of senior living communities. The size of our business also allows us to achieve increased efficiencies with respect to various corporate functions such as human resources, finance, accounting, legal, information technology and marketing. We are also able to realize cost efficiencies in the purchasing of food, supplies, insurance, benefits, and other goods and services. In addition, we have established centralized operations groups to support all of our product lines and communities in areas such as training, regulatory affairs, asset management, dining and procurement.

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Community Staffing and Training

Each community has an Executive Director responsible for the overall day-to-day operations of the community, including quality of service, social services and financial performance. Each Executive Director receives specialized training from us. In addition, a portion of each Executive Director's compensation is directly tied to the operating performance of the community and key service quality measures. We believe that the quality of our communities, coupled with our competitive compensation philosophy, has enabled us to attract high-quality, professional community Executive Directors.

Depending upon the size of the community, each Executive Director is supported by a community staff member who is directly responsible for day-to-day care of the residents and either community staff or regional support to oversee the community's marketing and community outreach programs. Other key positions supporting each community may include individuals responsible for food service, activities, housekeeping, and engineering.

We believe that quality of care and operating efficiency can be maximized by direct resident and staff contact. Employees involved in resident care, including the administrative staff, are trained in the support and care needs of the residents and emergency response techniques. We have adopted formal training and evaluation procedures to help ensure quality care for our residents. We have extensive policy and procedure manuals and hold frequent training sessions for management and staff at each site.

Quality Assurance

We maintain quality assurance programs at each of our communities through our corporate and regional staff. Our quality assurance program is designed to achieve a high degree of resident and family member satisfaction with the care and services that we provide. Our quality control measures include, among other things, community inspections conducted by corporate staff on a regular basis. These inspections cover the appearance of the exterior and grounds; the appearance and cleanliness of the interior; the professionalism and friendliness of staff; quality of resident care (including assisted living services, nursing care, therapy and home health programs); the quality of activities and the dining program; observance of residents in their daily living activities; and compliance with government regulations. Our quality control measures also include the survey of residents and family members on a regular basis to monitor their perception of the quality of services provided to residents.

In order to foster a sense of community as well as to respond to residents' desires, at many of our communities, we have established a resident council or other resident advisory committee that meets monthly with the Executive Director of the community. Separate resident committees also exist at many of these communities for food service, activities, marketing and hospitality. These committees promote resident involvement and satisfaction and enable community management to be more responsive to the residents' needs and desires.

Marketing and Sales

Our marketing strategy is intended to create awareness of us, our communities, our products and our services among potential residents and their family members and among referral sources, including hospital discharge planners, physicians, clergy, area agencies for the elderly, skilled nursing facilities, home health agencies and social workers. Our marketing staff develops overall strategies for promoting our communities and monitors the success of our marketing efforts, including outreach programs. In addition to direct contacts with prospective referral sources, we also rely on print advertising, yellow pages advertising, direct mail, signage and special events, health fairs and community receptions. Certain resident referral programs have been established and promoted within the limitations of federal and state laws at many communities.

In order to mitigate the impact of weakness in the housing market, we have recently implemented several new sales and marketing initiatives designed to increase our entrance fee sales results. These include the acceptance of short-term promissory notes in satisfaction of a resident's required entrance fee from certain pre-qualified, prospective residents who are waiting for their homes to sell. In addition, we have implemented the MyChoice program, which allows new and existing residents in certain communities the option to pay additional refundable entrance fee amounts in return for a reduced monthly service fee, thereby offering choices to residents desiring a more affordable ongoing monthly service fee.

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Competition

The senior living industry is highly competitive. We compete with numerous other organizations that provide similar senior living alternatives, such as home health care agencies, community-based service programs, retirement communities, convalescent centers and other senior living providers. In general, regulatory and other barriers to competitive entry in the retirement centers and assisted living segments of the senior living industry are not substantial, except in the skilled nursing segment. Although new construction of senior living communities has declined in recent years, we have experienced and expect to continue to experience competition in our efforts to acquire and operate senior living communities. Some of our present and potential senior living competitors have, or may obtain, greater financial resources than us and may have a lower cost of capital. Consequently, we may encounter competition that could limit our ability to attract residents or expand our business, which could have a material adverse effect on our revenues and earnings. Our major publicly-traded competitors are Sunrise Senior Living, Inc., Emeritus Corporation and Capital Senior Living Corporation and our major private competitors include Professional Community Management Life Care Services, LLC and Atria Senior Living Group, as well as a large number of not-for-profit entities.

Customers

Our target retirement center residents are senior citizens age 70 and older who desire or need a more supportive living environment. The average retirement center resident resides in a retirement center community for 37 months. A number of our retirement center residents relocate to one of our communities in order to be in a metropolitan area that is closer to their adult children.

Our target assisted living residents are predominantly senior citizens age 80 and older who require daily assistance with two or three ADLs. The average assisted living resident resides in an assisted living community for 23 months. Residents typically enter an assisted living community due to a relatively immediate need for services that might have been triggered by a medical event or need.

Our target CCRC residents are senior citizens who are seeking a community that offers a variety of services and a continuum of care so that they can “age in place.” These residents generally first enter the community as a resident of an retirement centers unit and may later move into an assisted living or skilled nursing unit as their needs change.

We believe our combination of retirement center and assisted living operating expertise and the broad base of customers that this enables us to target creates a unique opportunity for us to invest in a broad spectrum of assets in the senior living industry, including retirement center, assisted living, CCRC and skilled nursing communities.

Employees

As of December 31, 2008, we had approximately 22,200 full-time employees and approximately 9,000 part-time employees, of which 199 work in our Nashville headquarters office, 350 work in our Milwaukee office, 60 work in our Chicago office and 83 work in a variety of field-based management positions. We currently consider our relationship with our employees to be good.

Government Regulation

The regulatory environment surrounding the senior living industry continues to intensify in the number and type of laws and regulations affecting it. In addition, federal, state and local officials are increasingly focusing their efforts on enforcement of these laws and regulations. This is particularly true for large for-profit, multi-community providers

like us. Some of the laws and regulations that impact our industry include: state and local laws impacting licensure, protecting consumers against deceptive practices, and generally affecting the communities' management of property and equipment and how we otherwise conduct our operations, such as fire, health and safety laws and regulations and privacy laws; federal and state laws designed to protect Medicare and Medicaid, which mandate what are allowable costs, pricing, quality of services, quality of care, food service, resident rights (including abuse and neglect) and fraud; federal and state residents' rights statutes and regulations; Anti-Kickback and physicians referral ("Stark") laws; and safety and health standards set by the Occupational Safety and Health Administration. We are unable to predict the future course of federal, state and local legislation or regulation. Changes in the regulatory framework could have a material adverse effect on our business.

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Many senior living communities are also subject to regulation and licensing by state and local health and social service agencies and other regulatory authorities. Although requirements vary from state to state, these requirements may address, among others, the following: personnel education, training and records; community services, including administration of medication, assistance with self-administration of medication and the provision of nursing, home health and therapy services; staffing levels; monitoring of resident wellness; physical plant specifications; furnishing of resident units; food and housekeeping services; emergency evacuation plans; professional licensing and certification of staff prior to beginning employment; and resident rights and responsibilities, including in some states the right to receive health care services from providers of a resident's choice that are not our employees. In several of the states in which we operate or may operate, we are prohibited from providing certain higher levels of senior care services without first obtaining the appropriate licenses. In addition, in several of the states in which we operate or intend to operate, assisted living communities, home health agencies and/or skilled nursing facilities require a certificate of need before the community can be opened or the services at an existing community can be expanded. Senior living communities may also be subject to state and/or local building, zoning, fire and food service codes and must be in compliance with these local codes before licensing or certification may be granted. These laws and regulatory requirements could affect our ability to expand into new markets and to expand our services and communities in existing markets. In addition, if any of our presently licensed communities operates outside of its licensing authority, it may be subject to penalties, including closure of the community.

The intensified regulatory and enforcement environment impacts providers like us because of the increase in the number of inspections or surveys by governmental authorities and consequent citations for failure to comply with regulatory requirements. Unannounced surveys or inspections may occur annually or bi-annually, or following a regulator's receipt of a complaint about the community. From time to time in the ordinary course of business, we receive deficiency reports from state regulatory bodies resulting from such inspections or surveys. Most inspection deficiencies are resolved through an agreed-to plan of corrective action relating to the community's operations, but the reviewing agency typically has the authority to take further action against a licensed or certified community, which could result in the imposition of fines, imposition of a provisional or conditional license, suspension or revocation of a license, suspension or denial of admissions, loss of certification as a provider under federal health care programs or imposition of other sanctions, including criminal penalties. Loss, suspension or modification of a license may also cause us to default under our loan or lease agreements and/or trigger cross-defaults. Sanctions may be taken against providers or facilities without regard to the providers' or facilities' history of compliance. We may also expend considerable resources to respond to federal and state investigations or other enforcement action under applicable laws or regulations. To date, none of the deficiency reports received by us has resulted in a suspension, fine or other disposition that has had a material adverse effect on our revenues. However, any future substantial failure to comply with any applicable legal and regulatory requirements could result in a material adverse effect to our business as a whole. In addition, states Attorneys General vigorously enforce consumer protection laws as those laws relate to the senior living industry. State Medicaid Fraud and Abuse Units may also investigate assisted living communities even if the community or any of its residents do not receive federal or state funds.

Regulation of the senior living industry is evolving at least partly because of the growing interests of a variety of advocacy organizations and political movements attempting to standardize regulations for certain segments of the industry, particularly assisted living. Our operations could suffer if future regulatory developments, such as federal assisted living laws and regulations, as well as mandatory increases in the scope and severity of deficiencies determined by survey or inspection officials or increase the number of citations that can result in civil or criminal penalties. Certain current state laws and regulations allow enforcement officials to make determinations on whether the care provided by one or more of our communities exceeds the level of care for which the community is licensed. A finding that a community is delivering care beyond its license might result in the immediate transfer and discharge of residents, which may create market instability and other adverse consequences. Furthermore, certain states may allow citations in one community to impact other communities in the state. Revocation or suspension of a license, or a

citation, at a given community could therefore impact our ability to obtain new licenses or to renew existing licenses at other communities, which may also cause us to be in default under our loan or lease agreements and trigger cross-defaults or may also trigger defaults under certain of our credit agreements, or adversely affect our ability to operate and/or obtain financing in the future. If a state were to find that one community's citation will impact another of our communities, this will also increase costs and result in increased surveillance by the state survey agency. If regulatory requirements increase, whether

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through enactment of new laws or regulations or changes in the enforcement of existing rules, including increased enforcement brought about by advocacy groups, in addition to federal and state regulators, our operations could be adversely affected. In addition, any adverse finding by survey and inspection officials may serve as the basis for false claims lawsuits by private plaintiffs and may lead to investigations under federal and state laws, which may result in civil and/or criminal penalties against the community or individual.

There are various extremely complex federal and state laws governing a wide array of referrals, relationships and arrangements and prohibiting fraud by health care providers, including those in the senior living industry, and governmental agencies are devoting increasing attention and resources to such anti-fraud initiatives. The Health Insurance Portability and Accountability Act of 1996, or HIPAA, and the Balanced Budget Act of 1997 expanded the penalties for health care fraud. In addition, with respect to our participation in federal health care reimbursement programs, the government or private individuals acting on behalf of the government may bring an action under the False Claims Act alleging that a health care provider has defrauded the government and seek treble damages for false claims and the payment of additional monetary civil penalties. Recently, other health care providers have faced enforcement action under the False Claims Act. The False Claims Act allows a private individual with knowledge of fraud to bring a claim on behalf of the federal government and earn a percentage of the federal government's recovery. Because of these incentives, so-called "whistleblower" suits have become more frequent. Also, if any of our communities exceeds its level of care, we may be subject to private lawsuits alleging "transfer trauma" by residents. Such allegations could also lead to investigations by enforcement officials, which could result in penalties, including the closure of communities. The violation of any of these regulations may result in the imposition of fines or other penalties that could jeopardize our business.

Additionally, we operate communities that participate in federal and/or state health care reimbursement programs, including state Medicaid waiver programs for assisted living communities, the Medicare skilled nursing facility benefit program and other healthcare programs such as therapy and home health services, or other federal and/or state health care programs. Consequently, we are subject to federal and state laws that prohibit anyone from presenting, or causing to be presented, claims for reimbursement which are false, fraudulent or are for items or services that were not provided as claimed. Similar state laws vary from state to state and we cannot be sure that these laws will be interpreted consistently or in keeping with past practices. Violation of any of these laws can result in loss of licensure, claims for recoupment, civil or criminal penalties and exclusion of health care providers or suppliers from furnishing covered items or services to beneficiaries of the applicable federal and/or state health care reimbursement program. Loss of licensure may also cause us to default under our leases and loan agreements and/or trigger cross-defaults.

We are also subject to certain federal and state laws that regulate financial arrangements by health care providers, such as the Federal Anti-Kickback Law, the Stark laws and certain state referral laws. The Federal Anti-Kickback Law makes it unlawful for any person to offer or pay (or to solicit or receive) "any remuneration ... directly or indirectly, overtly or covertly, in cash or in kind" for referring or recommending for purchase any item or service which is eligible for payment under the Medicare and/or Medicaid programs. Authorities have interpreted this statute very broadly to apply to many practices and relationships between health care providers and sources of patient referral. If we were to violate the Federal Anti-Kickback Law, we may face criminal penalties and civil sanctions, including fines and possible exclusion from government programs such as Medicare and Medicaid, which may also cause us to default under our leases and loan agreements and/or trigger cross-defaults. Adverse consequences may also result if we violate federal Stark laws related to certain Medicare and Medicaid physician referrals. While we endeavor to comply with all laws that regulate the licensure and operation of our senior living communities, it is difficult to predict how our revenues could be affected if we were subject to an action alleging such violations. We are also subject to federal and state laws designed to protect the confidentiality of patient health information. The U.S. Department of Health and Human Services, or HHS, has issued rules pursuant to HIPAA relating to the privacy of such information. Rules that became effective April 14, 2003 govern our use and disclosure of health information at certain HIPAA covered

communities. We established procedures to comply with HIPAA privacy requirements at these communities. We were required to be in compliance with the HIPAA rule establishing administrative, physical and technical security standards for health information by April 2005. To the best of our knowledge, we are in compliance with these rules.

Environmental Matters

Under various federal, state and local environmental laws, a current or previous owner or operator of real property, such as us, may be held liable in certain circumstances for the costs of investigation, removal or

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remediation of certain hazardous or toxic substances, including, among others, petroleum and materials containing asbestos, that could be located on, in, at or under a property, regardless of how such materials came to be located there. Additionally, such an owner or operator of real property may incur costs relating to the release of hazardous or toxic substances, including government fines and payments for personal injuries or damage to adjacent property. The cost of any required investigation, remediation, removal, mitigation, compliance, fines or personal or property damages and our liability therefore could exceed the property's value and/or our assets' value. In addition, the presence of such substances, or the failure to properly dispose of or remediate the damage caused by such substances, may adversely affect our ability to sell such property, to attract additional residents and retain existing residents, to borrow using such property as collateral or to develop or redevelop such property. In addition, such laws impose liability for investigation, remediation, removal and mitigation costs on persons who disposed of or arranged for the disposal of hazardous substances at third-party sites. Such laws and regulations often impose liability without regard to whether the owner or operator knew of, or was responsible for, the presence, release or disposal of such substances as well as without regard to whether such release or disposal was in compliance with law at the time it occurred. Moreover, the imposition of such liability upon us could be joint and several, which means we could be required to pay for the cost of cleaning up contamination caused by others who have become insolvent or otherwise judgment proof.

We do not believe that we have incurred such liabilities that would have a material adverse effect on our business, financial condition and results of operations.

Our operations are subject to regulation under various federal, state and local environmental laws, including those relating to: the handling, storage, transportation, treatment and disposal of medical waste products generated at our communities; identification and warning of the presence of asbestos-containing materials in buildings, as well as removal of such materials; the presence of other substances in the indoor environment; and protection of the environment and natural resources in connection with development or construction of our properties.

Some of our communities generate infectious or other hazardous medical waste due to the illness or physical condition of the residents, including, for example, blood-soaked bandages, swabs and other medical waste products and incontinence products of those residents diagnosed with an infectious disease. The management of infectious medical waste, including its handling, storage, transportation, treatment and disposal, is subject to regulation under various federal, state and local environmental laws. These environmental laws set forth the management requirements for such waste, as well as related permit, record-keeping, notice and reporting obligations. Each of our communities has an agreement with a waste management company for the proper disposal of all infectious medical waste. The use of such waste management companies does not immunize us from alleged violations of such medical waste laws for operations for which we are responsible even if carried out by such waste management companies, nor does it immunize us from third-party claims for the cost to cleanup disposal sites at which such wastes have been disposed. Any finding that we are not in compliance with environmental laws could adversely affect our business operations and financial condition.

Federal regulations require building owners and those exercising control over a building's management to identify and warn, via signs and labels, their employees and certain other employers operating in the building of potential hazards posed by workplace exposure to installed asbestos-containing materials and potential asbestos-containing materials in their buildings. The regulations also set forth employee training, record-keeping requirements and sampling protocols pertaining to asbestos-containing materials and potential asbestos-containing materials. Significant fines can be assessed for violation of these regulations. Building owners and those exercising control over a building's management may be subject to an increased risk of personal injury lawsuits by workers and others exposed to asbestos-containing materials and potential asbestos-containing materials. The regulations may affect the value of a building containing asbestos-containing materials and potential asbestos-containing materials in which we have invested. Federal, state and local laws and regulations also govern the removal, encapsulation, disturbance, handling and/or disposal of

asbestos-containing materials and potential asbestos-containing materials when such materials are in poor condition or in the event of construction, remodeling, renovation or demolition of a building. Such laws may impose liability for improper handling or a release to the environment of asbestos-containing materials and potential asbestos-containing materials and may provide for fines to, and for third parties to seek recovery from, owners or operators of real properties for personal injury or improper work exposure associated with asbestos-containing materials and potential asbestos-containing materials.

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The presence of mold, lead-based paint, contaminants in drinking water, radon and/or other substances at any of the communities we own or may acquire may lead to the incurrence of costs for remediation, mitigation or the implementation of an operations and maintenance plan. Furthermore, the presence of mold, lead-based paint, contaminants in drinking water, radon and/or other substances at any of the communities we own or may acquire may present a risk that third parties will seek recovery from the owners, operators or tenants of such properties for personal injury or property damage. In some circumstances, areas affected by mold may be unusable for periods of time for repairs, and even after successful remediation, the known prior presence of extensive mold could adversely affect the ability of a community to retain or attract residents and could adversely affect a community's market value.

We believe that we are in material compliance with applicable environmental laws.

We are unable to predict the future course of federal, state and local environmental regulation and legislation. Changes in the environmental regulatory framework could have a material adverse effect on our business. In addition, because environmental laws vary from state to state, expansion of our operations to states where we do not currently operate may subject us to additional restrictions on the manner in which we operate our communities.

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to such reports, are available free of charge through our web site as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission, at the following address: www.brookdaleliving.com. The information within, or that can be accessed through, the web site is not part of this report.

We have posted our Corporate Governance Guidelines, Code of Business Conduct and Ethics and the charters of our Audit, Compensation, Investment, and Nominating and Corporate Governance Committees on our web site at www.brookdaleliving.com. In addition, our Code of Ethics for Chief Executive and Senior Financial Officers, which applies to our Chief Executive Officer, Co-Presidents, Chief Financial Officer, Treasurer and Controller, is also available on our website. Our corporate governance materials are available in print free of charge to any stockholder upon request to our Corporate Secretary, Brookdale Senior Living Inc., 111 Westwood Place, Suite 200, Brentwood, Tennessee 37027.

Item 1A. Risk Factors.

Risks Related to Our Business

Recent disruptions in the financial markets could affect our ability to obtain financing or to extend or refinance debt as it matures, which could negatively impact our liquidity, financial condition and the market price of our common stock.

The United States stock and credit markets have recently experienced significant price volatility, dislocations and liquidity disruptions, which have caused market prices of many stocks to fluctuate substantially and the spreads on prospective debt financings to widen considerably. These circumstances have materially impacted liquidity in the financial markets, making terms for certain financings less attractive, and in some cases have resulted in the unavailability of financing. Continued uncertainty in the stock and credit markets may negatively impact our ability to access additional financing (including any refinancing or extension of our existing debt) on reasonable terms, which may negatively affect our business.

Subsequent to December 31, 2008, we now have an available secured line of credit of \$230.0 million (including a \$25.0 million letter of credit sublimit) and separate letter of credit facilities of up to \$48.5 million in the aggregate. As of December 31, 2008, we also had \$158.5 million of debt that is scheduled to mature during the twelve months ending December 31, 2009 (excluding the \$4.5 million current portion of our line of credit). If we are unable to extend our amended credit facility, or enter into a new credit facility, at or prior to its August 31, 2010 maturity date or extend (or refinance, as applicable) any of our other debt or letter of credit facilities prior to their scheduled maturity dates, our liquidity and financial condition could be adversely impacted. In addition, even if we are able to extend or replace our credit facility at or prior to its maturity or extend or refinance our

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other maturing debt or letter of credit facilities, the terms of the new financing may not be as favorable to us as the terms of the existing financing.

A prolonged downturn in the financial markets may cause us to seek alternative sources of potentially less attractive financing, and may require us to further adjust our business plan accordingly. These events also may make it more difficult or costly for us to raise capital, including through the issuance of common stock. Continued disruptions in the financial markets could have an adverse effect on us and our business. If we are not able to obtain additional financing on favorable terms, we also may have to delay or abandon some or all of our growth strategies, which could adversely affect our revenues and results of operations.

If we are not able to satisfy the conditions precedent to exercising the extension options associated with certain of our debt agreements, our liquidity and financial condition could be negatively impacted.

Our consolidated financial statements reflect approximately \$158.5 million of debt obligations (excluding the \$4.5 million current portion of our line of credit) due on or prior to December 31, 2009. Although these debt obligations are scheduled to mature on or prior to December 31, 2009, we have the option, subject to the satisfaction of customary conditions (such as the absence of a material adverse change), to extend the maturity of approximately \$131.0 million of certain mortgages payable included in such debt until 2011, as the instruments associated with such mortgages payable provide that we can extend the respective maturity dates for up to two terms of 12 months each from the existing maturity dates. We presently anticipate that we will exercise the extension options and will satisfy the conditions precedent for doing so with respect to each of these obligations. If we are not able to satisfy the conditions precedent to exercising these extension options, our liquidity and financial condition could be adversely impacted.

Due to the dependency of our revenues on private pay sources, events which adversely affect the ability of seniors to afford our monthly resident fees or entrance fees (including downturns in the economy, housing market, consumer confidence or the equity markets) could cause our occupancy rates, revenues and results of operations to decline.

Costs to seniors associated with independent and assisted living services are not generally reimbursable under government reimbursement programs such as Medicare and Medicaid. Only seniors with income or assets meeting or exceeding the comparable median in the regions where our communities are located typically can afford to pay our monthly resident fees. Economic downturns, softness in the housing market, lower levels of consumer confidence, stock market volatility and/or changes in demographics could adversely affect the ability of seniors to afford our resident fees or entrance fees. If we are unable to retain and/or attract seniors with sufficient income, assets or other resources required to pay the fees associated with independent and assisted living services and other service offerings, our occupancy rates, revenues and results of operations could decline.

The inability of seniors to sell real estate may delay their moving into our communities, which could negatively impact our occupancy rates, revenues, cash flows and results of operations.

Recent housing price declines and reduced home mortgage availability have negatively affected the U.S. housing market, with certain geographic areas experiencing more acute deterioration than others. Downturns in the housing markets, such as the one we have recently experienced, could adversely affect the ability (or perceived ability) of seniors to afford our entrance fees and resident fees as our customers frequently use the proceeds from the sale of their homes to cover the cost of our fees. Specifically, if seniors have a difficult time selling their homes, these difficulties could impact their ability to relocate into our communities or finance their stays at our communities with private resources. If the recent volatility in the housing market continues for a protracted period, our occupancy rates, revenues, cash flows and results of operations could be negatively impacted.

General economic factors could adversely affect our financial performance and other aspects of our business.

General economic conditions, such as inflation, commodity costs, fuel and other energy costs, costs of labor, insurance and healthcare, interest rates, and tax rates, affect our community operating and general and administrative expenses, and we have no control or limited ability to control such factors. In addition, current global economic conditions and uncertainties, the potential impact of a prolonged recession, the potential for failures or realignments of financial institutions, and the related impact on available credit may affect us and our business partners, landlords, counterparties and residents or prospective residents in an adverse manner including,

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but not limited to, reducing access to liquid funds or credit, increasing the cost of credit, limiting our ability to manage interest rate risk, increasing the risk that certain of our business partners, landlords or counterparties would be unable to fulfill their obligations to us, and other impacts which we are unable to fully anticipate.

If we are unable to generate sufficient cash flow to cover required interest and lease payments, this would result in defaults of the related debt or leases and cross-defaults under other debt or leases, which would adversely affect our ability to continue to generate income.

We have significant indebtedness and lease obligations, and we intend to continue financing our communities through mortgage financing, long-term leases and other types of financing, including borrowings under our line of credit and future credit facilities we may obtain. We cannot give any assurance that we will generate sufficient cash flow from operations to cover required interest, principal and lease payments. Any non-payment or other default under our financing arrangements could, subject to cure provisions, cause the lender to foreclose upon the community or communities securing such indebtedness or, in the case of a lease, cause the lessor to terminate the lease, each with a consequent loss of income and asset value to us. Furthermore, in some cases, indebtedness is secured by both a mortgage on a community (or communities) and a guaranty by us and/or one or more of our subsidiaries. In the event of a default under one of these scenarios, the lender could avoid judicial procedures required to foreclose on real property by declaring all amounts outstanding under the guaranty immediately due and payable, and requiring the respective guarantor to fulfill its obligations to make such payments. The realization of any of these scenarios would have an adverse effect on our financial condition and capital structure. Additionally, a foreclosure on any of our properties could cause us to recognize taxable income, even if we did not receive any cash proceeds in connection with such foreclosure. Further, because our mortgages and leases generally contain cross-default and cross-collateralization provisions, a default by us related to one community could affect a significant number of our communities and their corresponding financing arrangements and leases.

Our indebtedness and long-term leases could adversely affect our liquidity and our ability to operate our business and our ability to execute our growth strategy.

Our level of indebtedness and our long-term leases could adversely affect our future operations and/or impact our stockholders for several reasons, including, without limitation:

- We may have little or no cash flow apart from cash flow that is dedicated to the payment of any interest, principal or amortization required with respect to outstanding indebtedness and lease payments with respect to our long-term leases;
- Increases in our outstanding indebtedness, leverage and long-term leases will increase our vulnerability to adverse changes in general economic and industry conditions, as well as to competitive pressure;
- Increases in our outstanding indebtedness may limit our ability to obtain additional financing for working capital, capital expenditures, expansions, new developments, acquisitions, general corporate and other purposes; and
 - Our ability to pay dividends to our stockholders may be limited.

Our ability to make payments of principal and interest on our indebtedness and to make lease payments on our leases depends upon our future performance, which will be subject to general economic conditions, industry cycles and financial, business and other factors affecting our operations, many of which are beyond our control. Our business might not continue to generate cash flow at or above current levels. If we are unable to generate sufficient cash flow from operations in the future to service our debt or to make lease payments on our leases, we may be required, among

other things, to seek additional financing in the debt or equity markets, refinance or restructure all or a portion of our indebtedness, sell selected assets, reduce or delay planned capital expenditures or delay or abandon desirable acquisitions. Such measures might not be sufficient to enable us to service our debt or to make lease payments on our leases. The failure to make required payments on our debt or leases or the delay or abandonment of our planned growth strategy could result in an adverse effect on our future ability to generate revenues and sustain profitability. In addition, any such financing, refinancing or sale of assets might not be available on economically favorable terms to us.

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Our existing credit facilities, mortgage loans and lease arrangements contain covenants that restrict our operations and any default under such facilities, loans or arrangements could result in the acceleration of indebtedness, termination of the leases or cross-defaults, any of which would negatively impact our liquidity and inhibit our ability to grow our business and increase revenues.

Our outstanding indebtedness and leases contain restrictions and covenants and require us to maintain or satisfy specified financial ratios and coverage tests, including maintaining prescribed net worth levels, leverage ratios and debt service and lease coverage ratios on a consolidated basis, and on a community or communities basis based on the debt or lease securing the communities. In addition, certain of our leases require us to maintain lease coverage ratios on a lease portfolio basis (each as defined in the leases) and maintain stockholders' equity or tangible net worth amounts. The debt service coverage ratios are generally calculated as revenues less operating expenses, including an implied management fee and a reserve for capital expenditures, divided by the debt (principal and interest) or lease payment. Net worth is generally calculated as stockholders' equity as calculated in accordance with GAAP, and in certain circumstances, reduced by intangible assets or liabilities or increased by deferred gains from sale-leaseback transactions and deferred entrance fee revenue. These restrictions and covenants may interfere with our ability to obtain financing or to engage in other business activities, which may inhibit our ability to grow our business and increase revenues. If we fail to comply with any of these requirements, then the related indebtedness could become immediately due and payable. We cannot assure you that we could pay this debt if it became due.

Our outstanding indebtedness and leases are secured by our communities and, in certain cases, a guaranty by us and/or one or more of our subsidiaries. Therefore, an event of default under the outstanding indebtedness or leases, subject to cure provisions in certain instances, would give the respective lenders or lessors, as applicable, the right to declare all amounts outstanding to be immediately due and payable, terminate the lease, foreclose on collateral securing the outstanding indebtedness and leases, and restrict our ability to make additional borrowings under the outstanding indebtedness or continue to operate the properties subject to the lease. Certain of our outstanding indebtedness and leases contain cross-default provisions so that a default under certain outstanding indebtedness would cause a default under certain of our leases. Certain of our outstanding indebtedness and leases also restrict, among other things, our ability to incur additional debt.

The substantial majority of our lease arrangements are structured as master leases. Under a master lease, we may lease a large number of geographically dispersed properties through an indivisible lease. As a result, it is difficult to restructure the composition of the portfolio or economic terms of the lease without the consent of the landlord. Failure to comply with Medicare or Medicaid provider requirements is a default under several of our master lease and debt financing instruments. In addition, potential defaults related to an individual property may cause a default of an entire master lease portfolio and could trigger cross-default provisions in our outstanding indebtedness and other leases, which would have a negative impact on our capital structure and our ability to generate future revenues, and could interfere with our ability to pursue our growth strategy.

Certain of our master leases also contain radius restrictions, which limit our ability to own, develop or acquire new communities within a specified distance from certain existing communities covered by such master leases. These radius restrictions could negatively affect our expansion, development and acquisition plans.

Mortgage debt and lease obligations expose us to increased risk of loss of property, which could harm our ability to generate future revenues and could have an adverse tax effect.

Mortgage debt and lease obligations increase our risk of loss because defaults on indebtedness secured by properties or pursuant to the terms of the lease may result in foreclosure actions initiated by lenders or lessors and ultimately our loss of the property securing any loans for which we are in default or cause the lessor to terminate the lease. For tax

purposes, a foreclosure of any of our properties would be treated as a sale of the property for a purchase price equal to the outstanding balance of the debt secured by the mortgage. If the outstanding balance of the debt secured by the mortgage exceeds our tax basis in the property, we would recognize taxable income on foreclosure, but would not receive any cash proceeds, which could negatively impact our earnings and liquidity. Further, our mortgage debt and leases generally contain cross-default and cross-collateralization provisions and a default on one community could affect a significant number of our communities, financing arrangements and leases.

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Increases in market interest rates could significantly increase the costs of our unhedged debt and lease obligations, which could adversely affect our liquidity and earnings.

Our unhedged floating-rate debt and lease payment obligations and any unhedged floating-rate debt incurred in the future, exposes us to interest rate risk. Therefore, increases in prevailing interest rates could increase our payment obligations, which would negatively impact our liquidity and earnings.

Changes in the value of our interest rate swaps could require us to post additional cash collateral with our counterparties, which could negatively impact our liquidity and financial condition.

In the normal course of our business, we use a variety of financial instruments to manage or hedge interest rate risk. We have entered into certain interest rate protection and swap agreements to effectively cap or convert floating rate debt to a fixed rate basis, as well as to hedge anticipated future financing transactions. Pursuant to our hedge agreements, we are required to secure our obligation to our counterparty if the fair value liability exceeds a specified threshold by posting cash or other collateral. In periods of significant volatility in the credit markets, the value of our swaps can change significantly and, as a result, the amount of collateral we are required to post can change significantly. If we are required to post additional collateral due to changes in the fair value liability of our existing or future swaps, our liquidity and financial condition could be negatively impacted.

We will rely on reimbursement from governmental programs for a greater portion of our revenues than in the past, and will be subject to changes in reimbursement levels, which could adversely affect our results of operations and cash flow.

We will rely on reimbursement from governmental programs for a greater portion of our revenues than before, and we cannot assure you that reimbursement levels will not decrease in the future, which could adversely affect our results of operations and cash flow. Certain per person annual limits on Medicare reimbursement for therapy services became effective in 2006, subject to certain exceptions. These exceptions are currently scheduled to expire on December 31, 2009. If these exceptions are modified or not extended beyond that date, there may be reductions in our therapy services revenue and the profitability of those services. There continue to be various federal and state legislative and regulatory proposals to implement cost containment measures that would limit payments to healthcare providers in the future. Changes in the reimbursement policies of the Medicare program could have an adverse effect on our results of operations and cash flow.

We have a limited operating history on a combined basis and we are therefore subject to the risks generally associated with the formation of any new business and the combination of existing businesses.

In June 2005, we were formed for the purpose of combining two leading senior living operating companies, Brookdale Living Communities, Inc., or BLC, and Alterra Healthcare Corporation, or Alterra, through a series of mergers that occurred in September 2005. Prior to this combination, we had no operations or assets. We are therefore subject to the risks generally associated with the formation of any new business and the combination of existing businesses, including the risk that we will not be able to realize expected efficiencies and economies of scale or implement our business strategies. As such, we only have a brief combined and consolidated operating history upon which investors may evaluate our performance as an integrated entity and assess our future prospects. In addition, from the date of our initial public offering in November 2005, we have purchased over 220 additional communities, including 83 communities from American Retirement Corporation, or ARC. There can be no assurance that we will be able to successfully integrate and oversee the combined operations of BLC, Alterra and ARC and the additional communities purchased in these acquisitions. Accordingly, our financial performance to date may not be indicative of our long-term future performance and may not necessarily reflect what our results of operations, financial condition and cash flows

would have been had we operated as a combined entity throughout the periods presented.

We have a history of losses and we may not be able to achieve profitability.

We have incurred net losses in every quarter since our formation in June 2005. Given our history of losses, there can be no assurance that we will be able to achieve and/or maintain profitability in the future. If we do not effectively manage our cash flow and combined business operations going forward or otherwise achieve profitability, our stock price would be adversely affected.

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If we do not effectively manage our growth and successfully integrate new or recently-acquired or initiated operations into our existing operations, our business and financial results could be adversely affected.

Our growth has and will continue to place significant demands on our current management resources. Our ability to manage our growth effectively and to successfully integrate new or recently-acquired or initiated operations (including expansions, developments, acquisitions and the expansion of our ancillary services program) into our existing business will require us to continue to expand our operational, financial and management information systems and to continue to retain, attract, train, motivate and manage key employees. There can be no assurance that we will be successful in attracting qualified individuals to the extent necessary, and management may expend significant time and energy attracting the appropriate personnel to manage assets we purchase in the future and our expansion and development activities. Also, the additional communities and expansion activities will require us to maintain consistent quality control measures that allow our management to effectively identify deviations that result in delivering care and services that are substandard, which may result in litigation and/or loss of licensure or certification. If we are unable to manage our growth effectively, successfully integrate new or recently-acquired or initiated operations into our existing business, or maintain consistent quality control measures, our business, financial condition and results of operations could be adversely affected.

Delays in obtaining regulatory approvals could hinder our plans to expand our ancillary services program, which could negatively impact our anticipated revenues, results of operations and cash flows.

We plan to continue to expand our offering of ancillary services (including therapy and home health) to additional communities. In the current environment, it is difficult to obtain certain required regulatory approvals. Delays in obtaining required regulatory approvals could impede our ability to expand to additional communities in accordance with our plans, which could negatively impact our anticipated revenues, results of operations and cash flows.

If we are unable to expand our communities in accordance with our plans, our anticipated revenues and results of operations could be adversely affected.

We are currently working on projects that will expand several of our existing senior living communities over the next several years. We are also developing certain new senior living communities. These projects are in various stages of development and are subject to a number of factors over which we have little or no control. Such factors include the necessity of arranging separate leases, mortgage loans or other financings to provide the capital required to complete these projects; difficulties or delays in obtaining zoning, land use, building, occupancy, licensing, certificate of need and other required governmental permits and approvals; failure to complete construction of the projects on budget and on schedule; failure of third-party contractors and subcontractors to perform under their contracts; shortages of labor or materials that could delay projects or make them more expensive; adverse weather conditions that could delay completion of projects; increased costs resulting from general economic conditions or increases in the cost of materials; and increased costs as a result of changes in laws and regulations. We cannot assure you that we will elect to undertake or complete all of our proposed expansion and development projects, or that we will not experience delays in completing those projects. In addition, we may incur substantial costs prior to achieving stabilized occupancy for each such project and cannot assure you that these costs will not be greater than we have anticipated. We also cannot assure you that any of our expansion or development projects will be economically successful. Our failure to achieve our expansion and development plans could adversely impact our growth objectives, and our anticipated revenues and results of operations.

We may encounter difficulties in acquiring communities at attractive prices or integrating acquisitions with our operations, which may adversely affect our operations and financial condition.

We will continue to selectively target strategic acquisitions as opportunities arise. The process of integrating acquired communities into our existing operations may result in unforeseen operating difficulties, divert managerial attention or require significant financial resources. These acquisitions and other future acquisitions may require us to incur additional indebtedness and contingent liabilities, and may result in unforeseen expenses or compliance issues, which may limit our revenue growth, cash flows, and our ability to achieve profitability. Moreover, any future acquisitions may not generate any additional income for us or provide any benefit to our business. In addition, we cannot assure you that we will be able to locate and acquire communities at attractive prices in locations that are compatible with our strategy or that competition for the acquisition of communities

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will not increase. Finally, when we are able to locate communities and enter into definitive agreements to acquire or lease them, we cannot assure you that the transactions will be completed. Failure to complete transactions after we have entered into definitive agreements may result in significant expenses to us.

Unforeseen costs associated with the acquisition of communities could reduce our future profitability.

Our growth strategy contemplates selected future acquisitions of existing senior living operating companies and communities. Despite our extensive underwriting and due diligence procedures, communities that we have previously acquired or may acquire in the future may generate unexpectedly low or no returns or may not meet a risk profile that our investors find acceptable. In addition, we might encounter unanticipated difficulties and expenditures relating to any of the acquired communities, including contingent liabilities, or newly acquired communities might require significant management attention that would otherwise be devoted to our ongoing business. For example, a community may require capital expenditures in excess of budgeted amounts, or it may experience management turnover that is higher than we project. These costs may negatively affect our future profitability.

Competition for the acquisition of strategic assets from buyers with lower costs of capital than us or that have lower return expectations than we do could limit our ability to compete for strategic acquisitions and therefore to grow our business effectively.

Several real estate investment trusts, or REITs, have similar asset acquisition objectives as we do, along with greater financial resources and lower costs of capital than we are able to obtain. This may increase competition for acquisitions that would be suitable to us, making it more difficult for us to compete and successfully implement our growth strategy. There is significant competition among potential acquirers in the senior living industry, including REITs, and there can be no assurance that we will be able to successfully implement our growth strategy or complete acquisitions, which could limit our ability to grow our business effectively.

We may need additional capital to fund our operations and finance our growth, and we may not be able to obtain it on terms acceptable to us, or at all, which may limit our ability to grow.

Continued expansion of our business through the expansion of our existing communities, the development of new communities and the acquisition of existing senior living operating companies and communities will require additional capital, particularly if we were to accelerate our expansion and acquisition plans. Financing may not be available to us or may be available to us only on terms that are not favorable. In addition, certain of our outstanding indebtedness and long-term leases restrict, among other things, our ability to incur additional debt. If we are unable to raise additional funds or obtain them on terms acceptable to us, we may have to delay or abandon some or all of our growth strategies. Further, if additional funds are raised through the issuance of additional equity securities, the percentage ownership of our stockholders would be diluted. Any newly issued equity securities may have rights, preferences or privileges senior to those of our common stock.

We are susceptible to risks associated with the lifecare benefits that we offer the residents of our lifecare entrance fee communities.

As of December 31, 2008, we operated ten lifecare entrance fee communities that offer residents a limited lifecare benefit. Residents of these communities pay an upfront entrance fee upon occupancy, of which a portion is generally refundable, with an additional monthly service fee while living in the community. This limited lifecare benefit is typically (a) a certain number of free days in the community's health center during the resident's lifetime, (b) a discounted rate for such services, or (c) a combination of the two. The lifecare benefit varies based upon the extent to which the resident's entrance fee is refundable. The pricing of entrance fees, refundability provisions, monthly service

fees, and lifecare benefits are determined utilizing actuarial projections of the expected morbidity and mortality of the resident population. In the event the entrance fees and monthly service payments established for our communities are not sufficient to cover the cost of lifecare benefits granted to residents, the results of operations and financial condition of these communities could be adversely affected.

Residents of these entrance fee communities are guaranteed a living unit and nursing care at the community during their lifetime, even if the resident exhausts his or her financial resources and becomes unable to satisfy his or her obligations to the community. In addition, in the event a resident requires nursing care and there is insufficient capacity for the resident in the nursing facility at the community where the resident lives, the

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community must contract with a third party to provide such care. Although we screen potential residents to ensure that they have adequate assets, income, and reimbursements from government programs and third parties to pay their obligations to our communities during their lifetime, we cannot assure you that such assets, income, and reimbursements will be sufficient in all cases. If insufficient, we have rights of set-off against the refundable portions of the residents' deposits, and would also seek available reimbursement under Medicaid or other available programs. To the extent that the financial resources of some of the residents are not sufficient to pay for the cost of facilities and services provided to them, or in the event that our communities must pay third parties to provide nursing care to residents of our communities, our results of operations and financial condition would be adversely affected.

The geographic concentration of our communities could leave us vulnerable to an economic downturn, regulatory changes or acts of nature in those areas, resulting in a decrease in our revenues or an increase in our costs, or otherwise negatively impacting our results of operations.

We have a high concentration of communities in various geographic areas, including the states of Florida, Texas, North Carolina, California, Colorado, Ohio and Arizona. As a result of this concentration, the conditions of local economies and real estate markets, changes in governmental rules and regulations, particularly with respect to assisted living communities, acts of nature and other factors that may result in a decrease in demand for senior living services in these states could have an adverse effect on our revenues, costs and results of operations. In addition, given the location of our communities, we are particularly susceptible to revenue loss, cost increase or damage caused by other severe weather conditions or natural disasters such as hurricanes, earthquakes or tornados. Any significant loss due to a natural disaster may not be covered by insurance and may lead to an increase in the cost of insurance.

Termination of our resident agreements and vacancies in the living spaces we lease could adversely affect our revenues, earnings and occupancy levels.

State regulations governing assisted living communities require written resident agreements with each resident. Several of these regulations also require that each resident have the right to terminate the resident agreement for any reason on reasonable notice. Consistent with these regulations, many of our assisted living resident agreements allow residents to terminate their agreements upon 0 to 30 days' notice. Unlike typical apartment leasing or independent living arrangements that involve lease agreements with specified leasing periods of up to a year or longer, in many instances we cannot contract with our assisted living residents to stay in those living spaces for longer periods of time. Our retirement center resident agreements generally provide for termination of the lease upon death or allow a resident to terminate his or her lease upon the need for a higher level of care not provided at the community. If multiple residents terminate their resident agreements at or around the same time, our revenues, earnings and occupancy levels could be adversely affected. In addition, because of the demographics of our typical residents, including age and health, resident turnover rates in our communities are difficult to predict. As a result, the living spaces we lease may be unoccupied for a period of time, which could adversely affect our revenues and earnings.

Increases in the cost and availability of labor, including increased competition for or a shortage of skilled personnel or increased union activity, would have an adverse effect on our profitability and/or our ability to conduct our business operations.

Our success depends on our ability to retain and attract skilled management personnel who are responsible for the day-to-day operations of each of our communities. Each community has an Executive Director responsible for the overall day-to-day operations of the community, including quality of care, social services and financial performance. Depending upon the size of the community, each Executive Director is supported by a community staff member who is directly responsible for day-to-day care of the residents and either community staff or regional support to oversee the community's marketing and community outreach programs. Other key positions supporting each community may

include individuals responsible for food service, healthcare services, therapy services, activities, housekeeping and engineering. We compete with various health care service providers, including other senior living providers, in retaining and attracting qualified and skilled personnel. Increased competition for or a shortage of nurses, therapists or other trained personnel, or general inflationary pressures may require that we enhance our pay and benefits package to compete effectively for such personnel. We may not be able to offset such added costs by increasing the rates we charge to our residents or our service charges, which would negatively impact our results of operations. Turnover rates and the magnitude of the shortage of nurses,

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therapists or other trained personnel varies substantially from market to market. Although reliable industry-wide data on key employee retention does not exist, we believe that our employee retention rates are consistent with those of other national senior housing operators. If we fail to attract and retain qualified and skilled personnel, our ability to conduct our business operations effectively, our ability to implement our growth strategy, and our overall operating results could be harmed.

In addition, efforts by labor unions to unionize any of our community personnel could divert management attention, lead to increases in our labor costs and/or reduce our flexibility with respect to certain workplace rules. Recently proposed legislation known as the Employee Free Choice Act, or card check, could make it significantly easier for union organizing drives to be successful, leading to increased organizational activity, and could give third-party arbitrators the ability to impose terms of collective bargaining agreements upon us and a labor union if we and such union are unable to agree to the terms of a collective bargaining agreement. If we experience an increase in organizing activity, if onerous collective bargaining agreement terms are imposed upon us, or if we otherwise experience an increase in our staffing and labor costs, our profitability and cash flows from operations would be negatively affected.

Departure of our key officers could harm our business.

Our future success depends, to a significant extent, upon the continued service of our senior management personnel, particularly: W.E. Sheriff, our Chief Executive Officer; Mark W. Ohlendorf, our Co-President and Chief Financial Officer; John P. Rijos, our Co-President and Chief Operating Officer; and T. Andrew Smith, our Executive Vice President, General Counsel and Secretary. If we were to lose the services of any of these individuals, our business and financial results could be adversely affected.

Environmental contamination at any of our communities could result in substantial liabilities to us, which may exceed the value of the underlying assets and which could materially and adversely effect our liquidity and earnings.

Under various federal, state and local environmental laws, a current or previous owner or operator of real property, such as us, may be held liable in certain circumstances for the costs of investigation, removal or remediation of, or related to the release of, certain hazardous or toxic substances, that could be located on, in, at or under a property, regardless of how such materials came to be located there. The cost of any required investigation, remediation, removal, mitigation, compliance, fines or personal or property damages and our liability therefore could exceed the property's value and/or our assets' value. In addition, the presence of such substances, or the failure to properly dispose of or remediate the damage caused by such substances, may adversely affect our ability to sell such property, to attract additional residents and retain existing residents, to borrow using such property as collateral or to develop or redevelop such property. In addition, such laws impose liability, which may be joint and several, for investigation, remediation, removal and mitigation costs on persons who disposed of or arranged for the disposal of hazardous substances at third party sites. Such laws and regulations often impose liability without regard to whether the owner or operator knew of, or was responsible for, the presence, release or disposal of such substances as well as without regard to whether such release or disposal was in compliance with law at the time it occurred. Although we do not believe that we have incurred such liabilities as would have a material adverse effect on our business, financial condition and results of operations, we could be subject to substantial future liability for environmental contamination that we have no knowledge about as of the date of this report and/or for which we may not be at fault.

Failure to comply with existing environmental laws could result in increased expenditures, litigation and potential loss to our business and in our asset value, which would have an adverse effect on our earnings and financial condition.

Our operations are subject to regulation under various federal, state and local environmental laws, including those relating to: the handling, storage, transportation, treatment and disposal of medical waste products generated at our communities; identification and warning of the presence of asbestos-containing materials in buildings, as well as removal of such materials; the presence of other substances in the indoor environment; and protection of the environment and natural resources in connection with development or construction of our properties.

Some of our communities generate infectious or other hazardous medical waste due to the illness or physical condition of the residents. Each of our communities has an agreement with a waste management company for the

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proper disposal of all infectious medical waste, but the use of such waste management companies does not immunize us from alleged violations of such laws for operations for which we are responsible even if carried out by such waste management companies, nor does it immunize us from third-party claims for the cost to cleanup disposal sites at which such wastes have been disposed.

Federal regulations require building owners and those exercising control over a building's management to identify and warn their employees and certain other employers operating in the building of potential hazards posed by workplace exposure to installed asbestos-containing materials and potential asbestos-containing materials in their buildings. Significant fines can be assessed for violation of these regulations. Building owners and those exercising control over a building's management may be subject to an increased risk of personal injury lawsuits. Federal, state and local laws and regulations also govern the removal, encapsulation, disturbance, handling and/or disposal of asbestos-containing materials and potential asbestos-containing materials when such materials are in poor condition or in the event of construction, remodeling, renovation or demolition of a building. Such laws may impose liability for improper handling or a release to the environment of asbestos-containing materials and potential asbestos-containing materials and may provide for fines to, and for third parties to seek recovery from, owners or operators of real properties for personal injury or improper work exposure associated with asbestos-containing materials and potential asbestos-containing materials.

The presence of mold, lead-based paint, contaminants in drinking water, radon and/or other substances at any of the communities we own or may acquire may lead to the incurrence of costs for remediation, mitigation or the implementation of an operations and maintenance plan and may result in third party litigation for personal injury or property damage. Furthermore, in some circumstances, areas affected by mold may be unusable for periods of time for repairs, and even after successful remediation, the known prior presence of extensive mold could adversely affect the ability of a community to retain or attract residents and could adversely affect a community's market value.

Although we believe that we are currently in material compliance with applicable environmental laws, if we fail to comply with such laws in the future, we would face increased expenditures both in terms of fines and remediation of the underlying problem(s), potential litigation relating to exposure to such materials, and potential decrease in value to our business and in the value of our underlying assets. Therefore, our failure to comply with existing environmental laws would have an adverse effect on our earnings, our financial condition and our ability to pursue our growth strategy.

We are unable to predict the future course of federal, state and local environmental regulation and legislation. Changes in the environmental regulatory framework could have a material adverse effect on our business. In addition, because environmental laws vary from state to state, expansion of our operations to states where we do not currently operate may subject us to additional restrictions on the manner in which we operate our communities.

We are subject to risks associated with complying with Section 404 of the Sarbanes-Oxley Act of 2002.

We are subject to various regulatory requirements, including the Sarbanes-Oxley Act of 2002. Under Section 404 of the Sarbanes-Oxley Act of 2002, our management is required to include a report with each Annual Report on Form 10-K regarding our internal control over financial reporting. We have implemented processes documenting and evaluating our system of internal controls. Complying with these requirements is expensive, time consuming and subject to changes in regulatory requirements. The existence of one or more material weaknesses, management's conclusion that its internal control over financial reporting is not effective, or the inability of our auditors to express an opinion that our internal control over financial reporting is effective, could result in a loss of investor confidence in our financial reports, adversely affect our stock price and/or subject us to sanctions or investigation by regulatory authorities.

Risks Related to Pending Litigation

Complaints filed against us could, if adversely determined, subject us to a material loss.

We have been and are currently involved in litigation and claims incidental to the conduct of our business which are comparable to other companies in the senior living industry. Certain claims and lawsuits allege large damage amounts and may require significant costs to defend and resolve. Similarly, the senior living industry is

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continuously subject to scrutiny by governmental regulators, which could result in litigation related to regulatory compliance matters. As a result, we maintain insurance policies in amounts and with coverage and deductibles we believe are adequate, based on the nature and risks of our business, historical experience and industry standards. Effective January 1, 2009, our current policies provide for deductibles of \$250,000 for each claim. Accordingly, we are, in effect, self-insured for most claims. If we experience a greater number of losses than we anticipate under these policies, or if certain claims are not ultimately covered by insurance, our results of operation and financial condition could be adversely affected.

Risks Related to Our Industry

The cost and difficulty of complying with increasing and evolving regulation and enforcement could have an adverse effect on our business operations and profits.

The regulatory environment surrounding the senior living industry continues to evolve and intensify in the amount and type of laws and regulations affecting it, many of which vary from state to state. In addition, many senior living communities are subject to regulation and licensing by state and local health and social service agencies and other regulatory authorities. In several of the states in which we operate or may operate, we are prohibited from providing certain higher levels of senior care services without first obtaining the appropriate licenses. Also, in several of the states in which we operate or intend to operate, assisted living communities and/or skilled nursing facilities require a certificate of need before the community can be opened or the services at an existing community can be expanded. Furthermore, federal, state and local officials are increasingly focusing their efforts on enforcement of these laws, particularly with respect to large for-profit, multi-community providers like us. These requirements, and the increased enforcement thereof, could affect our ability to expand into new markets, to expand our services and communities in existing markets and, if any of our presently licensed communities were to operate outside of its licensing authority, may subject us to penalties including closure of the community. Future regulatory developments as well as mandatory increases in the scope and severity of deficiencies determined by survey or inspection officials could cause our operations to suffer. We are unable to predict the future course of federal, state and local legislation or regulation. If regulatory requirements increase, whether through enactment of new laws or regulations or changes in the enforcement of existing rules, our earnings and operations could be adversely affected.

The intensified regulatory and enforcement environment impacts providers like us because of the increase in the number of inspections or surveys by governmental authorities and consequent citations for failure to comply with regulatory requirements. We also expend considerable resources to respond to federal and state investigations or other enforcement action. From time to time in the ordinary course of business, we receive deficiency reports from state and federal regulatory bodies resulting from such inspections or surveys. Although most inspection deficiencies are resolved through an agreed-to plan of corrective action, the reviewing agency typically has the authority to take further action against a licensed or certified facility, which could result in the imposition of fines, imposition of a provisional or conditional license, suspension or revocation of a license, suspension or denial of admissions, loss of certification as a provider under federal health care programs or imposition of other sanctions, including criminal penalties. Furthermore, certain states may allow citations in one community to impact other communities in the state. Revocation of a license at a given community could therefore impact our ability to obtain new licenses or to renew existing licenses at other communities, which may also cause us to be in default under our leases, trigger cross-defaults, trigger defaults under certain of our credit agreements or adversely affect our ability to operate and/or obtain financing in the future. If a state were to find that one community's citation would impact another of our communities, this would also increase costs and result in increased surveillance by the state survey agency. To date, none of the deficiency reports received by us has resulted in a suspension, fine or other disposition that has had a material adverse effect on our revenues. However, the failure to comply with applicable legal and regulatory requirements in the future could result in a material adverse effect to our business as a whole.

There are various extremely complex federal and state laws governing a wide array of referral relationships and arrangements and prohibiting fraud by health care providers, including those in the senior living industry, and governmental agencies are devoting increasing attention and resources to such anti-fraud initiatives. Some examples are the Health Insurance Portability and Accountability Act of 1996, or HIPAA, the Balanced Budget Act of 1997, and the False Claims Act, which gives private individuals the ability to bring an action on behalf of the federal government. The violation of any of these laws or regulations may result in the imposition of fines or other penalties that could increase our costs and otherwise jeopardize our business. Under the Deficit Reduction

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Act of 2005, or DRA 2005, every entity that receives at least \$5 million annually in Medicaid payments must have established written policies for all employees, contractors or agents, providing detailed information about false claims, false statements and whistleblower protections under certain federal laws, including the federal False Claims Act, and similar state laws. Failure to comply with this new compliance requirement may potentially give rise to potential liability. DRA 2005 also creates an incentive for states to enact false claims laws that are comparable to the federal False Claims Act.

Additionally, we provide services and operate communities that participate in federal and/or state health care reimbursement programs, which makes us subject to federal and state laws that prohibit anyone from presenting, or causing to be presented, claims for reimbursement which are false, fraudulent or are for items or services that were not provided as claimed. Similar state laws vary from state to state and we cannot be sure that these laws will be interpreted consistently or in keeping with past practice. Violation of any of these laws can result in loss of licensure, civil or criminal penalties and exclusion of health care providers or suppliers from furnishing covered items or services to beneficiaries of the applicable federal and/or state health care reimbursement program. Loss of licensure may also cause us to default under our leases and/or trigger cross-defaults.

We are also subject to certain federal and state laws that regulate financial arrangements by health care providers, such as the Federal Anti-Kickback Law, the Stark laws and certain state referral laws. Authorities have interpreted the Federal Anti-Kickback Law very broadly to apply to many practices and relationships between health care providers and sources of patient referral. This could result in criminal penalties and civil sanctions, including fines and possible exclusion from government programs such as Medicare and Medicaid, which may also cause us to default under our leases and/or trigger cross-defaults. Adverse consequences may also result if we violate federal Stark laws related to certain Medicare and Medicaid physician referrals. While we endeavor to comply with all laws that regulate the licensure and operation of our business, it is difficult to predict how our revenues could be affected if we were subject to an action alleging such violations.

Compliance with the Americans with Disabilities Act (especially as recently amended), Fair Housing Act and fire, safety and other regulations may require us to make unanticipated expenditures, which could increase our costs and therefore adversely affect our earnings and financial condition.

All of our communities are required to comply with the Americans with Disabilities Act, or ADA. The ADA has separate compliance requirements for “public accommodations” and “commercial properties,” but generally requires that buildings be made accessible to people with disabilities. Compliance with ADA requirements could require removal of access barriers and non-compliance could result in imposition of government fines or an award of damages to private litigants.

We must also comply with the Fair Housing Act, which prohibits us from discriminating against individuals on certain bases in any of our practices if it would cause such individuals to face barriers in gaining residency in any of our communities. Additionally, the Fair Housing Act and other state laws require that we advertise our services in such a way that we promote diversity and not limit it. We may be required, among other things, to change our marketing techniques to comply with these requirements.

In addition, we are required to operate our communities in compliance with applicable fire and safety regulations, building codes and other land use regulations and food licensing or certification requirements as they may be adopted by governmental agencies and bodies from time to time. Like other health care facilities, senior living communities are subject to periodic survey or inspection by governmental authorities to assess and assure compliance with regulatory requirements. Surveys occur on a regular (often annual or bi-annual) schedule, and special surveys may result from a specific complaint filed by a resident, a family member or one of our competitors. We may be required

to make substantial capital expenditures to comply with those requirements.

Capital expenditures we have made to comply with any of the above to date have been immaterial, however, the increased costs and capital expenditures that we may incur in order to comply with any of the above would result in a negative effect on our earnings, and financial condition.

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Significant legal actions and liability claims against us in excess of insurance limits could subject us to increased operating costs and substantial uninsured liabilities, which may adversely affect our financial condition and operating results.

The senior living business entails an inherent risk of liability, particularly given the demographics of our residents, including age and health, and the services we provide. In recent years, we, as well as other participants in our industry, have been subject to an increasing number of claims and lawsuits alleging that our services have resulted in resident injury or other adverse effects. Many of these lawsuits involve large damage claims and significant legal costs. Many states continue to consider tort reform and how it will apply to the senior living industry. We may continue to be faced with the threat of large jury verdicts in jurisdictions that do not find favor with large senior living providers. We maintain liability insurance policies in amounts and with the coverage and deductibles we believe are adequate based on the nature and risks of our business, historical experience and industry standards. We have formed a wholly-owned “captive” insurance company for the purpose of insuring certain portions of our risk retention under our general and professional liability insurance programs. There can be no guarantee that we will not have any claims that exceed our policy limits in the future.

If a successful claim is made against us and it is not covered by our insurance or exceeds the policy limits, our financial condition and results of operations could be materially and adversely affected. In some states, state law may prohibit or limit insurance coverage for the risk of punitive damages arising from professional liability and general liability claims and/or litigation. As a result, we may be liable for punitive damage awards in these states that either are not covered or are in excess of our insurance policy limits. Also, the above deductibles, or self-insured retention, are accrued based on an actuarial projection of future liabilities. If these projections are inaccurate and if there are an unexpectedly large number of successful claims that result in liabilities in excess of our self-insured retention, our operating results could be negatively affected. Claims against us, regardless of their merit or eventual outcome, also could have a material adverse effect on our ability to attract residents or expand our business and could require our management to devote time to matters unrelated to the day-to-day operation of our business. We also have to renew our policies every year and negotiate acceptable terms for coverage, exposing us to the volatility of the insurance markets, including the possibility of rate increases. There can be no assurance that we will be able to obtain liability insurance in the future or, if available, that such coverage will be available on acceptable terms.

Overbuilding and increased competition may adversely affect our ability to generate and increase our revenues and profits and to pursue our business strategy.

The senior living industry is highly competitive, and we expect that it may become more competitive in the future. We compete with numerous other companies that provide long-term care alternatives such as home healthcare agencies, therapy services, life care at home, community-based service programs, retirement communities, convalescent centers and other independent living, assisted living and skilled nursing providers, including not-for-profit entities. In general, regulatory and other barriers to competitive entry in the independent living and assisted living segments of the senior living industry are not substantial. We have experienced and expect to continue to experience increased competition in our efforts to acquire and operate senior living communities. Consequently, we may encounter increased competition that could limit our ability to attract new residents, raise resident fees or expand our business, which could have a material adverse effect on our revenues and earnings.

In addition, overbuilding in the late 1990’s in the senior living industry reduced the occupancy rates of many newly constructed buildings and, in some cases, reduced the monthly rate that some newly built and previously existing communities were able to obtain for their services. This resulted in lower revenues for certain of our communities during that time. While we believe that overbuilt markets have stabilized and should continue to be stabilized for the immediate future, we cannot be certain that the effects of this period of overbuilding will not effect our occupancy and

resident fee rate levels in the future, nor can we be certain that another period of overbuilding in the future will not have the same effects. Moreover, while we believe that the new construction dynamics and the competitive environments in the states in which we operate are substantially similar to the national market, taken as a whole, if the dynamics or environment were to be significantly adverse in one or more of those states, it would have a disproportionate effect on our revenues (due to the large portion of our revenues that are generated in those states).

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Risks Related to Our Organization and Structure

If the ownership of our common stock continues to be highly concentrated, it may prevent you and other stockholders from influencing significant corporate decisions and may result in conflicts of interest.

As of December 31, 2008, funds managed by affiliates of Fortress beneficially own 60,875,826 shares, or approximately 57.8% of our outstanding common stock (including unvested restricted shares). In addition, two of our directors are associated with Fortress. As a result, funds managed by affiliates of Fortress are able to control fundamental and significant corporate matters and transactions, including: the election of directors; mergers, consolidations or acquisitions; the sale of all or substantially all of our assets and other decisions affecting our capital structure; the amendment of our amended and restated certificate of incorporation and our amended and restated by-laws; and the dissolution of the Company. Fortress's interests, including its ownership of the North American operations of Holiday Retirement Corp., one of our competitors, may conflict with your interests. Their control of the Company could delay, deter or prevent acts that may be favored by our other stockholders such as hostile takeovers, changes in control of the Company and changes in management. As a result of such actions, the market price of our common stock could decline or stockholders might not receive a premium for their shares in connection with a change of control of the Company.

Anti-takeover provisions in our amended and restated certificate of incorporation and our amended and restated by-laws may discourage, delay or prevent a merger or acquisition that you may consider favorable or prevent the removal of our current board of directors and management.

Certain provisions of our amended and restated certificate of incorporation and our amended and restated by-laws may discourage, delay or prevent a merger or acquisition that you may consider favorable or prevent the removal of our current board of directors and management. We have a number of anti-takeover devices in place that will hinder takeover attempts, including:

- a staggered board of directors consisting of three classes of directors, each of whom serve three-year terms;
- removal of directors only for cause, and only with the affirmative vote of at least 80% of the voting interest of stockholders entitled to vote;
- blank-check preferred stock;
- provisions in our amended and restated certificate of incorporation and amended and restated by-laws preventing stockholders from calling special meetings (with the exception of Fortress and its affiliates, so long as they collectively beneficially own at least 50.1% of our issued and outstanding common stock);
- advance notice requirements for stockholders with respect to director nominations and actions to be taken at annual meetings; and
- no provision in our amended and restated certificate of incorporation for cumulative voting in the election of directors, which means that the holders of a majority of the outstanding shares of our common stock can elect all the directors standing for election.

Additionally, our amended and restated certificate of incorporation provides that Section 203 of the Delaware General Corporation Law, which restricts certain business combinations with interested stockholders in certain situations, will not apply to us. This may make it easier for a third party to acquire an interest in some or all of us with Fortress'

approval, even though our other stockholders may not deem such an acquisition beneficial to their interests.

We are a holding company with no operations and rely on our operating subsidiaries to provide us with funds necessary to meet our financial obligations.

We are a holding company with no material direct operations. Our principal assets are the equity interests we directly or indirectly hold in our operating subsidiaries. As a result, we are dependent on loans, dividends and

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other payments from our subsidiaries to generate the funds necessary to meet our financial obligations. Our subsidiaries are legally distinct from us and have no obligation to make funds available to us.

Risks Related to Our Common Stock

The market price and trading volume of our common stock may be volatile, which could result in rapid and substantial losses for our stockholders.

The market price of our common stock may be highly volatile and could be subject to wide fluctuations. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. If the market price of our common stock declines significantly, you may be unable to resell your shares at or above your purchase price. We cannot assure you that the market price of our common stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common stock include:

- variations in our quarterly operating results;
- changes in our earnings estimates;
- the contents of published research reports about us or the senior living industry or the failure of securities analysts to cover our common stock;
- additions or departures of key management personnel;
- any increased indebtedness we may incur or lease obligations we may enter into in the future;
- actions by institutional stockholders;
- changes in market valuations of similar companies;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- speculation or reports by the press or investment community with respect to the Company or the senior living industry in general;
- increases in market interest rates that may lead purchasers of our shares to demand a higher yield;
- changes or proposed changes in laws or regulations affecting the senior living industry or enforcement of these laws and regulations, or announcements relating to these matters; and
- general market and economic conditions.

Future offerings of debt or equity securities by us may adversely affect the market price of our common stock.

In the future, we may attempt to increase our capital resources by offering debt or additional equity securities, including commercial paper, medium-term notes, senior or subordinated notes, series of preferred shares or shares of our common stock. Upon liquidation, holders of our debt securities and preferred stock, and lenders with respect to

other borrowings, would receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the economic and voting rights of our existing stockholders or reduce the market price of our common stock, or both. Shares of our preferred stock, if issued, could have a preference with respect to liquidating distributions or a preference with respect to dividend payments that could limit our ability to pay dividends to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of our common stock bear the risk of our future offerings reducing the market price of our common stock and diluting their share holdings in us.

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We may issue all of the shares of our common stock that are authorized but unissued and not otherwise reserved for issuance under our stock incentive plans without any action or approval by our stockholders. We intend to continue to pursue selected acquisitions of senior living communities and may issue shares of common stock in connection with these acquisitions. Any shares issued in connection with our acquisitions or otherwise would dilute the holdings of our current stockholders.

The market price of our common stock could be negatively affected by sales of substantial amounts of our common stock in the public markets.

At February 23, 2009, 101,722,806 shares of our common stock were outstanding (excluding unvested restricted shares). All of the shares of our common stock are freely transferable, except for any shares held by our “affiliates,” as that term is defined in Rule 144 under the Securities Act of 1933, as amended, or the Securities Act, or any shares otherwise subject to the limitations of Rule 144.

Pursuant to our Stockholders Agreement, Fortress and certain of its affiliates and permitted third-party transferees have the right, in certain circumstances, to require us to register their shares of our common stock under the Securities Act for sale into the public markets. Upon the effectiveness of such a registration statement, all shares covered by the registration statement will be freely transferable. In addition, as of December 31, 2008, we had registered under the Securities Act an aggregate of 5,700,000 shares for issuance under our Omnibus Stock Incentive Plan and an aggregate of 1,000,000 shares for issuance under our Associate Stock Purchase Plan. In accordance with the terms of the Omnibus Stock Incentive Plan, the number of shares available for issuance automatically increases by 400,000 shares on January 1 of each year. Pursuant to the terms of the Associate Stock Purchase Plan, the number of shares available for purchase under the plan will automatically increase by 200,000 shares on the first day of each calendar year beginning January 1, 2010. Subject to any restrictions imposed on the shares and options granted under our stock incentive programs, shares registered under these registration statements will be available for sale into the public markets.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Facilities

At December 31, 2008, we operated 548 communities across 35 states, with the capacity to serve over 51,800 residents. Of the communities we operated at December 31, 2008, we owned 168, we leased 358 pursuant to operating and capital leases, and 22 were managed by us and fully or majority owned by third parties.

The following table sets forth certain information regarding our communities at December 31, 2008:

State	Occupancy		Ownership Status			Total
	Units/Beds	Rate(1)	Owned	Leased	Managed	
Alabama	1,113	90.7%	2	5	-	7
Arizona	2,154	88.7%	3	11	2	16
California	3,067	89.7%	13	7	-	20
Colorado	2,895	86.1%	5	19	2	26
Connecticut	289	80.3%	-	2	-	2

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Delaware	54	100.0%	1	-	-	1
Florida	8,817	85.9%	35	39	3	77
Georgia	568	78.7%	4	-	1	5
Idaho	228	95.6%	2	1	-	3
Illinois	2,465	91.4%	1	10	-	11
Indiana	1,139	85.5%	4	10	-	14
Iowa	139	95.0%	1	-	-	1
Kansas	1,319	88.0%	10	10	2	22
Kentucky	291	100.0%	-	1	-	1
Louisiana	84	100.0%	1	-	-	1
Massachusetts	281	94.0%	-	1	-	1

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Michigan	2,489	93.3%	5	26	2	33
Minnesota	763	83.6%	-	16	1	17
Mississippi	54	35.3%	-	1	-	1
Missouri	937	89.5%	2	1	-	3
Nevada	306	94.1%	-	3	-	3
New Jersey	534	79.4%	2	6	-	8
New Mexico	343	92.7%	-	2	-	2
New York	1,196	94.4%	6	10	-	16
North Carolina	4,013	99.8%	3	50	-	53
Ohio	2,385	82.7%	14	19	-	33
Oklahoma	1,177	88.2%	3	24	1	28
Oregon	830	92.5%	4	8	-	12
Pennsylvania	999	85.4%	4	3	1	8
South Carolina	563	83.4%	4	7	-	11
Tennessee	1,399	86.2%	14	8	-	22
Texas	5,855	91.6%	17	33	7	57
Virginia	1,403	93.1%	2	3	-	5
Washington	1,181	86.3%	4	9	-	13
Wisconsin	474	89.4%	2	13	-	15
Total	51,804	89.3%	168	358	22	548

(1) Includes the impact of managed properties.

A significant majority of our owned properties are subject to mortgages.

Corporate Offices

Our main corporate offices are all leased, including our 51,988 square foot facility in Nashville, Tennessee, our 93,573 square foot facility in Milwaukee, Wisconsin and our 30,314 square foot facility in Chicago, Illinois.

Item 3. Legal Proceedings.

The information contained in Note 21 to the consolidated financial statements contained in Part II, Item 8 of this Annual Report on Form 10-K is incorporated herein by reference.

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable.

Executive Officers of the Registrant

The following table sets forth certain information concerning our executive officers as of February 23, 2009:

Name	Age	Position
W.E. Sheriff	66	Chief Executive Officer
Mark W. Ohlendorf	48	Co-President and Chief Financial Officer
John P. Rijos	56	Co-President and Chief Operating Officer
T. Andrew Smith	48	Executive Vice President, General Counsel and Secretary

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Bryan D. Richardson	50	Executive Vice President and Chief Administrative Officer
Kristin A. Ferge	35	Executive Vice President and Treasurer
George T. Hicks	51	Executive Vice President – Finance
H. Todd Kaestner	53	Executive Vice President – Corporate Development
Gregory B. Richard	54	Executive Vice President – Field Operations

W.E. Sheriff has served as our Chief Executive Officer since February 2008. He previously served as our Co-Chief Executive Officer from July 2006 until February 2008. Previously, Mr. Sheriff served as Chairman and Chief Executive Officer of ARC and its predecessors since April 1984 and as its President since November 2003.

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From 1973 to 1984, Mr. Sheriff served in various capacities for Ryder System, Inc., including as President and Chief Executive Officer of its Truckstops of America division. Mr. Sheriff also serves on the boards of various educational and charitable organizations and in varying capacities with several trade organizations.

Mark W. Ohlendorf became our Co-President in August 2005 and our Chief Financial Officer in March 2007. Mr. Ohlendorf previously served as Chief Executive Officer and President of Alterra from December 2003 until August 2005. From January 2003 through December 2003, Mr. Ohlendorf served as Chief Financial Officer and President of Alterra, and from 1999 through 2002 he served as Senior Vice President and Chief Financial Officer of Alterra. Mr. Ohlendorf has over 25 years of experience in the health care and long-term care industries, having held leadership positions with such companies as Sterling House Corporation, Vitas Healthcare Corporation and Horizon/CMS Healthcare Corporation. He is a member of the board of directors of the Assisted Living Federation of America.

John P. Rijos became our Co-President in August 2005 and our Chief Operating Officer in January 2008. Previously, Mr. Rijos served as President and Chief Operating Officer and as a director of BLC since August 2000. Prior to joining BLC in August 2000, Mr. Rijos spent 16 years with Lane Hospitality Group, owners and operators of over 40 hotels and resorts, as its President and Chief Operating Officer. From 1981 to 1985 he served as President of High Country Corporation, a Denver-based hotel development and management company. Prior to that time, Mr. Rijos was Vice President of Operations and Development of several large real estate trusts specializing in hotels. Mr. Rijos has over 25 years of experience in the acquisition, development and operation of hotels and resorts. He serves on many tourist-related operating boards and committees, as well as advisory committees for Holiday Inns, Sheraton Hotels and the City of Chicago and the Board of Trustees for Columbia College. Mr. Rijos is a certified hospitality administrator.

T. Andrew Smith became our Executive Vice President, General Counsel and Secretary in October 2006. Previously, Mr. Smith was with Bass, Berry & Sims PLC in Nashville, Tennessee from 1985 to 2006. Mr. Smith was a member of that firm's corporate and securities group, and served as the chair of the firm's healthcare group.

Bryan D. Richardson became our Executive Vice President in July 2006 and our Chief Administrative Officer in January 2008. Mr. Richardson also served as our Chief Accounting Officer from September 2006 through April 2008. Previously, Mr. Richardson served as Executive Vice President – Finance and Chief Financial Officer of ARC since April 2003 and previously served as its Senior Vice President – Finance since April 2000. Mr. Richardson was formerly with a national graphic arts company from 1984 to 1999 serving in various capacities, including Senior Vice President of Finance of a digital prepress division from May 1994 to October 1999, and Senior Vice President of Finance and Chief Financial Officer from 1989 to 1994. Mr. Richardson was previously with the national public accounting firm PriceWaterhouseCoopers.

Kristin A. Ferge became our Executive Vice President and Treasurer in August 2005. Ms. Ferge also served as our Chief Administrative Officer from March 2007 through December 2007. She previously served as Vice President, Chief Financial Officer and Treasurer of Alterra from December 2003 until August 2005. From April 2000 through December 2003, Ms. Ferge served as Alterra's Vice President of Finance and Treasurer. Prior to joining Alterra, she worked in the audit division of KPMG LLP. Ms. Ferge is a certified public accountant.

George T. Hicks became our Executive Vice President – Finance in July 2006. Previously, Mr. Hicks served as Executive Vice President – Finance and Internal Audit, Secretary and Treasurer of ARC since September 1993. Mr. Hicks had served in various capacities for ARC's predecessors since 1985, including Chief Financial Officer from September 1993 to April 2003 and Vice President – Finance and Treasurer from November 1989 to September 1993.

H. Todd Kaestner became our Executive Vice President – Corporate Development in July 2006. Previously, Mr. Kaestner served as Executive Vice President – Corporate Development of ARC since September 1993. Mr. Kaestner

served in various capacities for ARC's predecessors since 1985, including Vice President – Development from 1988 to 1993 and Chief Financial Officer from 1985 to 1988.

Gregory B. Richard has served as our Executive Vice President – Field Operations since January 2008. He previously served as our Executive Vice President – Operations from July 2006 through December 2007. Previously, Mr. Richard served as Executive Vice President and Chief Operating Officer of ARC since January

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2003 and previously served as its Executive Vice President-Community Operations since January 2000. Mr. Richard was formerly with a pediatric practice management company from May 1997 to May 1999, serving as President and Chief Executive Officer from October 1997 to May 1999. Prior to this, Mr. Richard was with Rehabilitation Corporation, a publicly traded outpatient physical rehabilitation service provider, from July 1986 to October 1996, serving as Senior Vice President of Operations and Chief Operating Officer from September 1992 to October 1996.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock is traded on the New York Stock Exchange, or the NYSE, under the symbol "BKD". The following table sets forth the range of high and low sales prices of our common stock and dividend information for each quarter for the last two fiscal years.

	Fiscal 2008		
	High	Low	Dividends Declared
First Quarter	\$ 28.29	\$ 20.46	\$ 0.25
Second Quarter	\$ 27.22	\$ 20.15	\$ 0.25
Third Quarter	\$ 27.05	\$ 14.06	\$ 0.25
Fourth Quarter	\$ 21.84	\$ 3.03	—

	Fiscal 2007		
	High	Low	Dividends Declared
First Quarter	\$ 49.94	\$ 43.13	\$ 0.45
Second Quarter	\$ 48.36	\$ 41.73	\$ 0.50
Third Quarter	\$ 48.41	\$ 33.53	\$ 0.50
Fourth Quarter	\$ 41.70	\$ 27.50	\$ 0.50

The closing sale price of our common stock as reported on the NYSE on February 23, 2009 was \$3.99 per share. As of that date, there were approximately 544 holders of record of our common stock.

Dividend Policy

On December 30, 2008, our Board of Directors voted to suspend our quarterly cash dividend indefinitely. Although we anticipate that, over the intermediate and longer-term, we will pay regular quarterly dividends to the holders of our common stock, over the near term we are focused on preserving liquidity. Accordingly, we do not expect to pay cash dividends on our common stock for the foreseeable future. In addition, our amended credit facility currently prohibits us from paying dividends or making cash distributions on our common stock.

Our ability to pay and maintain cash dividends in the future will be based on many factors, including then-existing contractual restrictions or limitations, our ability to execute our growth strategy, our ability to negotiate favorable lease and other contractual terms, anticipated operating expense levels, the level of demand for our units/beds, occupancy rates, entrance fee sales results, the rates we charge, our liquidity position and actual results that may vary

substantially from estimates. Some of the factors are beyond our control and a change in any such factor could affect our ability to pay or maintain dividends. We can give no assurance as to our ability to pay or maintain dividends in the future. We also cannot assure you that the level of dividends will be maintained or increase over time or that increases in demand for our units/beds and monthly resident fees will increase our actual cash available for dividends to stockholders. As we have done in the past, we may also pay dividends in the future that exceed our net income for the relevant period as calculated in accordance with U.S. GAAP.

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Recent Sales of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Item 6. Selected Financial Data.

The selected financial data should be read in conjunction with the sections entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Business” and our historical consolidated financial statements and the related notes included elsewhere herein. The consolidated financial data includes Brookdale Living Communities, Inc. and Alterra Healthcare Corporation for all periods presented and the acquisition of ARC, effective July 25, 2006. Other acquisitions are discussed in Note 4 in the notes to the consolidated financial statements. Our historical statement of operations data and balance sheet data as of and for each of the years in the five-year period ended December 31, 2008 have been derived from our audited financial statements.

	For the Years Ended December 31, (1)				
	2008	2007	2006	2005	2004
Fiscal Year ended December 31, (in thousands, except per share data)					
Total revenue	\$ 1,928,054	\$ 1,839,296	\$ 1,309,913	\$ 790,577	\$ 660,872
Facility operating expense	1,261,581	1,170,937	819,801	493,887	415,169
General and administrative expense	140,919	138,013	117,897	81,696	43,640
Facility lease expense	269,469	271,628	228,779	189,339	99,997
Depreciation and amortization	276,202	299,925	188,129	47,048	50,153
Goodwill and asset impairment	220,026	—	—	—	—
Total operating expense	2,168,197	1,880,503	1,354,606	811,970	608,959
(Loss) income from operations	(240,143)	(41,207)	(44,693)	(21,393)	51,913
Interest income	7,618	7,519	6,810	3,788	637
Interest expense					
Debt	(147,389)	(143,991)	(97,694)	(46,248)	(63,634)
Amortization of deferred financing costs	(9,707)	(7,064)	(5,061)	(2,835)	(2,154)
Change in fair value of derivatives and amortization	(68,146)	(73,222)	(38)	3,992	3,176
(Loss) gain on extinguishment of debt	(3,052)	(2,683)	(1,526)	(3,996)	1,051
Equity in loss of unconsolidated ventures	(861)	(3,386)	(3,705)	(838)	(931)
Other non-operating income (loss)	1,708	402	—	—	(114)
Loss before taxes	(459,972)	(263,632)	(145,907)	(67,530)	(10,056)
Benefit (provision) for income taxes	86,731	101,260	38,491	97	(11,111)
Loss before minority interest	(373,241)	(162,372)	(107,416)	(67,433)	(21,167)
Minority interest	—	393	(671)	16,575	11,734
Loss before discontinued operations and cumulative effect of a change in accounting principle	(373,241)	(161,979)	(108,087)	(50,858)	(9,433)
Loss on discontinued operations	—	—	—	(128)	(361)

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Net loss	\$ (373,241)	\$ (161,979)	\$ (108,087)	\$ (50,986)	\$ (9,794)
Basic and diluted loss per share					
Loss before discontinued operations and cumulative effect of a change in accounting principle	\$ (3.67)	\$ (1.60)	\$ (1.34)	\$ (1.35)	\$ (0.49)
Loss on discontinued operations	—	—	—	—	(0.02)
Net loss	\$ (3.67)	\$ (1.60)	\$ (1.34)	\$ (1.35)	\$ (0.51)

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Weighted average shares of common stock used in computing basic and diluted loss per share	101,667	101,511	80,842	37,636	19,185
Dividends declared per share of common stock	\$ 0.75	\$ 1.95	\$ 1.55	\$ 0.50	\$ —
Other Operating Data:					
Total number of facilities (at end of period)	548	550	546	383	367
Total units/beds operated(2)	51,804	52,086	51,271	30,057	26,208
Occupancy rate at period end	89.5%	90.6%	91.1%	89.6%	89.4%
Average monthly revenue per unit/bed(3)	\$ 3,791	\$ 3,577	\$ 3,247	\$ 2,991	\$ 2,827
		For the Years Ended December 31,			
	2008	2007	2006	2005	2004
Cash and cash equivalents	\$ 53,973	\$ 100,904	\$ 68,034	\$ 77,682	\$ 86,858
Total assets	4,449,258	4,811,622	4,756,000	1,697,811	746,625
Total debt	2,552,929	2,335,224	1,874,939	754,301	371,037
Total stockholders' equity	960,601	1,419,538	1,764,012	630,403	40,091

(1) Prior to October 1, 2006, the effective portion of the change in fair value of derivatives was recorded in other comprehensive income and the ineffective portion was included in the change in fair value of derivatives in the consolidated statements of operations. On October 1, 2006, we elected to discontinue hedge accounting prospectively for the previously designated swap instruments. Gains and losses accumulated in other comprehensive income at that date of \$1.3 million related to the previously designated swap instruments are being amortized to interest expense over the life of the underlying hedged debt payments. Although hedge accounting was discontinued on October 1, 2006, the swap instruments remained outstanding and are carried at fair value in the consolidated balance sheets and the change in fair value beginning October 1, 2006 has been included in the consolidated statements of operations.

(2) Total units/beds operated represent the total units/beds operated as of the end of the period.

(3) Average monthly revenue per unit/bed represents the average of the total monthly revenues, excluding amortization of entrance fees, divided by average occupied units/beds.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

7.

The following information should be read in conjunction with our "Selected Financial Data" and our consolidated financial statements and related notes, included elsewhere in this Annual Report on Form 10-K. In addition to historical information, this discussion and analysis may contain forward-looking statements that involve risks, uncertainties and assumptions, which could cause actual results to differ materially from management's expectations. Please see additional risks and uncertainties described in "Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995" for more information. Factors that could cause such differences include those described in "Risk Factors" which appears elsewhere in this Annual Report on Form 10-K.

Executive Overview

During 2008, we continued to make progress in implementing our long-term growth strategy, integrating our previous acquisitions, and building a platform for future growth. Our primary long-term growth objectives are to grow our revenues, Adjusted EBITDA, Cash From Facility Operations and Facility Operating Income primarily through a combination of: (i) organic growth in our core business, including expense control and the realization

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of economies of scale; (ii) continued expansion of our ancillary services programs (including therapy and home health services); and (iii) expansion of our existing communities.

Our operating results for the twelve months ended December 31, 2008 were favorably impacted by an increase in our total revenues and average monthly revenue per unit/bed across all segments. Although we made progress in certain areas of our business, our recent operating results have been negatively impacted by unfavorable conditions in the housing, credit and financial markets and by deteriorating conditions in the overall economy, resulting in lower than anticipated occupancy rates and increased levels of expenses. In response to these conditions, we are focusing on maintaining occupancy, increasing our ancillary services programs, and controlling expenses (including by limiting our capital expenditures).

We are also taking steps to preserve our liquidity and increase our financial flexibility during 2009. For example, we have suspended our quarterly dividend payments and have terminated our share repurchase program. As discussed in more detail under “Credit Facilities - Refinancing of Existing Line of Credit” below, we also recently entered into an amended credit facility with Bank of America, N.A., as administrative agent, providing for a \$230.0 million revolving credit facility that matures on August 31, 2010. Furthermore, we have extended the maturity of a number of mortgage loans, and, after giving effect to contractual extension options, will have virtually no mortgage debt maturities until 2011. Finally, we have taken steps to reduce materially our exposure to collateralization requirements associated with interest rate swaps.

In the fourth quarter of 2008, similar to many companies, we experienced a significant decline in the market value of our common stock due primarily to the depressed macroeconomic environment and volatility in the equity markets. As a result, our market capitalization eroded in the fourth quarter when compared to previous periods and was significantly below book value. In accordance with the requirements of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (“SFAS 142”), we performed an impairment test of the goodwill for each of our reporting units as of the end of the fourth quarter. We determined fair values of the reporting units and their underlying assets using discounted cash flows. As a result of our impairment tests, we recorded a non-cash goodwill impairment charge of \$215.0 million for the quarter ended December 31, 2008. The impairment charge was primarily driven by the adverse equity market conditions intensifying in the fourth quarter of 2008 that caused a decrease in current market multiples and our stock price at December 31, 2008 compared with our stock price at September 30, 2008. Our reporting units under SFAS 142 are our operational segments and the goodwill impairment charge related entirely to our CCRCs segment. The non-cash charge does not impact our ongoing business operations, liquidity, cash flows from operating activities or financial covenants and will not result in any future cash expenditure. We also evaluated all long-lived depreciable assets using the same cash flow data used to evaluate goodwill and determined that the undiscounted cash flows exceeded the carrying value of the assets for all except for four communities within the Assisted Living segment. As a result, we recorded a non-cash asset impairment charge of \$5.0 million for the quarter ended December 31, 2008.

The table below presents a summary of our operating results and certain other financial metrics for the years ended December 31, 2008 and 2007 and the amount and percentage of increase or decrease of each applicable item (dollars in millions).

	Years Ended		Increase	
	December 31,		(Decrease)	
	2008	2007	Amount	Percent
Total revenue	\$ 1,928.1	\$ 1,839.3	\$ 88.8	4.8%
Net loss(1)	\$ (373.2)	\$ (162.0)	\$ (211.2)	(130.4%)
Adjusted EBITDA	\$ 302.6	\$ 306.4	\$ (3.8)	(1.2%)

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Cash From Facility Operations	\$	130.1	\$	143.2	\$	(13.1)	(9.1%)
Facility Operating Income	\$	637.5	\$	642.3	\$	(4.8)	(0.7%)

(1) Net loss for 2008 includes non-cash impairment charges of \$220.0 million.

Adjusted EBITDA and Facility Operating Income are non-GAAP financial measures we use in evaluating our operating performance. Cash From Facility Operations is a non-GAAP financial measure we use in evaluating our liquidity. See “Non-GAAP Financial Measures” below for an explanation of how we define each of these measures, a detailed description of why we believe such measures are useful and the limitations of each measure,

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a reconciliation of net loss to each of Adjusted EBITDA and Facility Operating Income and a reconciliation of net cash provided by operating activities to Cash From Facility Operations. In the first quarter of 2008 we changed our definition of Cash From Facility Operations to include lease financing debt amortization with fair market value or no purchase options. Prior periods have been restated for comparative purposes.

Our revenues for the year ended December 31, 2008 increased to \$1.9 billion, an increase of \$88.8 million, or approximately 4.8%, over our revenues for the year ended December 31, 2007. The increase in revenues in the current year was primarily a result of an increase in the average revenue per unit/bed compared to the prior year and growing revenues from our ancillary services programs, partially offset by a decline in occupancy from the prior year. Our weighted average occupancy rate for the year ended December 31, 2008 was 89.6% compared to 90.7% for the year ended December 31, 2007.

Although our revenues increased period over period, our overall financial results for the year ended December 31, 2008 were negatively impacted by a higher than customary level of expense growth.

During the year ended December 31, 2008, our Adjusted EBITDA, Cash From Facility Operations and Facility Operating Income decreased by 1.2%, 9.1% and 0.7%, respectively, when compared to the year ended December 31, 2007. Adjusted EBITDA and Cash From Facility Operations for the year ended December 31, 2008 were negatively impacted by \$4.8 million of hurricane and named tropical storms expense and an \$8.0 million charge to general and administrative expense relating to the establishment of a reserve for certain litigation (Note 21).

During 2008, we repurchased 1,211,301 shares of our common stock at a cost of approximately \$29.2 million. Our Board of Directors terminated our share repurchase program on February 25, 2009. In addition, our amended credit facility effectively prohibits us from repurchasing shares of our common stock.

During the year, we continued to expand our ancillary services offerings. As of December 31, 2008, we offered therapy services to 35,049 of our units and home health services to 16,730 of our units. We expect to continue to expand our ancillary services programs to additional units and to open or acquire additional home health agencies. We also continue to see positive results from the maturation of previously-opened therapy and home health clinics.

During the year, we advanced our expansion program, completing expansions at seven communities (with a total of 186 units). We currently have seven projects under construction with a total of 753 units.

We believe that the deteriorating housing market, credit crisis and general economic uncertainty have caused some potential customers (or their adult children) to delay or reconsider moving into our communities, resulting in a decrease in occupancy rates and occupancy levels when compared to the prior year periods. We remain cautious about the economy and the adverse credit and financial markets and their effect on our customers and our business. In addition, we continue to experience volatility in the entrance fee portion of our business. The timing of entrance fee sales is subject to a number of different factors (including the ability of potential customers to sell their existing homes) and is also inherently subject to variability (positively or negatively) when measured over the short-term. These factors also impact our potential independent living customers to a significant extent. We expect occupancy to decline slightly over the near term and we expect occupancy and entrance fee sales to normalize over the longer term.

Consolidated Results of Operations

Year Ended December 31, 2008 and 2007

The following table sets forth, for the periods indicated, statement of operations items and the amount and percentage of change of these items. The results of operations for any particular period are not necessarily indicative of results for any future period. The following data should be read in conjunction with our consolidated financial statements and the notes thereto, which are included herein. Our results reflect the inclusion of acquisitions that occurred during the respective reporting periods. Refer to our Annual Report on Form 10-K for the year ended December 31, 2007, filed February 29, 2008, and the notes to the consolidated financial statements included herein for additional information regarding 2007 acquisitions.

Certain prior period amounts have been reclassified to conform to the current year presentation.

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(dollars in thousands)	Years Ended December 31,		Increase (Decrease)	
	2008	2007	Amount	Percent
Statement of Operations Data:				
Total revenue				
Resident fees				
Retirement Centers	\$ 542,180	\$ 532,680	\$ 9,500	1.8%
Assisted Living	845,348	799,070	46,278	5.8%
CCRCs	533,532	500,757	32,775	6.5%
Total resident fees	1,921,060	1,832,507	88,553	4.8%
Management fees	6,994	6,789	205	3.0%
Total revenue	1,928,054	1,839,296	88,758	4.8%
Expense				
Facility operating expense(1)				
Retirement Centers	313,469	299,086	14,383	4.8%
Assisted Living	563,210	514,130	49,080	9.5%
CCRCs	384,902	357,721	27,181	7.6%
Total facility operating expense	1,261,581	1,170,937	90,644	7.7%
General and administrative expense	140,919	138,013	2,906	2.1%
Facility lease expense	269,469	271,628	(2,159)	(0.8%)
Depreciation and amortization	276,202	299,925	(23,723)	(7.9%)
Goodwill and asset impairment	220,026	—	220,026	100%
Total operating expense	2,168,197	1,880,503	287,694	15.3%
Loss from operations	(240,143)	(41,207)	(198,936)	(482.8%)
Interest income	7,618	7,519	99	1.3%
Interest expense				
Debt	(147,389)	(143,991)	(3,398)	(2.4%)
Amortization of deferred financing costs	(9,707)	(7,064)	(2,643)	(37.4%)
Change in fair value of derivatives and amortization	(68,146)	(73,222)	5,076	6.9%
Loss on extinguishment of debt	(3,052)	(2,683)	(369)	(13.8%)
Equity in loss of unconsolidated ventures	(861)	(3,386)	2,525	74.6%
Other non-operating income	1,708	402	1,306	324.9%
Loss before income taxes	(459,972)	(263,632)	(196,340)	(74.5%)
Benefit for income taxes	86,731	101,260	(14,529)	(14.3%)
Loss before minority interest	(373,241)	(162,372)	(210,869)	(129.9%)
Minority interest	—	393	(393)	(100%)
Net loss	\$ (373,241)	\$ (161,979)	\$ (211,262)	(130.4%)
Selected Operating and Other Data:				
Total number of communities (at end of period)	548	550	(2)	(0.4%)
Total units/beds operated(2)	51,804	52,086	(282)	(0.5%)
Owned/leased communities units/beds	47,455	47,670	(215)	(0.5%)
Owned/leased communities occupancy rate:				
Period end	89.5%	90.6%	(1.1%)	(1.2%)
Weighted average	89.6%	90.7%	(1.1%)	(1.2%)
Average monthly revenue per unit/bed(3)	\$ 3,791	\$ 3,577	214	6.0%
Selected Segment Operating and Other Data				
Retirement Centers				
Number of communities (period end)	85	87	(2)	(2.3%)

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Total units/beds(2)	15,251	15,805	(554)	(3.5%)
Occupancy rate:				
Period end	89.9%	91.7%	(1.8%)	(2.0%)
Weighted average	90.3%	92.4%	(2.1%)	(2.3%)
Average monthly revenue per unit/bed(3)	\$ 3,229	\$ 3,067	162	5.3%

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Assisted Living

Number of communities (period end)	409	409	—	—
Total units/beds(2)	21,021	21,012	9	0.0%
Occupancy rate:				
Period end	90.2%	89.7%	0.5%	0.6%
Weighted average	89.9%	89.7%	0.2%	0.2%
Average monthly revenue per unit/bed(3)	\$ 3,738	\$ 3,537	201	5.7%

CCRCs

Number of communities (period end)	32	32	—	—
Total units/beds(2)	11,183	10,853	330	3.0%
Occupancy rate:				
Period end	87.7%	90.8%	(3.1%)	(3.4%)
Weighted average	87.9%	90.0%	(2.1%)	(2.3%)
Average monthly revenue per unit/bed(3)	\$ 4,759	\$ 4,481	278	6.2%

Management Services

Number of communities (period end)	22	22	—	—
Total units/beds(2)	4,349	4,416	(67)	(1.5%)
Occupancy rate:				
Period end	87.1%	83.1%	4.0%	4.8%
Weighted average	84.9%	87.1%	(2.2%)	(2.5%)

Selected Entrance Fee Data:

	2008				
	Q1	Q2	Q3	Q4	YTD
Non-refundable entrance fees sales	\$ 2,780	\$ 5,177	\$ 7,253	\$ 7,391	\$ 22,601
Refundable entrance fees sales(4)	3,492	7,420	4,273	4,686	19,871
Total entrance fee receipts	6,272	12,597	11,526	12,077	42,472
Refunds	(3,632)	(4,843)	(5,856)	(4,819)	(19,150)
Net entrance fees	\$ 2,640	\$ 7,754	\$ 5,670	\$ 7,258	\$ 23,322
	2007				
	Q1	Q2	Q3	Q4	YTD
Non-refundable entrance fees sales	\$ 3,916	\$ 4,726	\$ 5,673	\$ 5,015	\$ 19,330
Refundable entrance fees sales(4)	4,258	4,064	8,696	8,901	25,919
Total entrance fee receipts	8,174	8,790	14,369	13,916	45,249
Refunds	(6,315)	(4,089)	(5,084)	(4,069)	(19,557)
Net entrance fees	\$ 1,859	\$ 4,701	\$ 9,285	\$ 9,847	\$ 25,692

(1) Segment facility operating expense for the year ended December 31, 2008 includes hurricane and named tropical storms expense totaling \$4.8 million consisting of \$1.3 million for Retirement Centers, \$2.0 million for Assisted Living and \$1.5 million for CCRCs. There was no hurricane and named tropical storms expense in 2007. Facility operating expense for the year ended December 31, 2007 includes \$7.0 million of charges comprised of \$5.9 million of estimated uncollectible accounts and \$1.1 million of accounting conformity adjustments pertaining to inventory and certain accrual policies.

(2) Total units/beds operated represent the total units/beds operated as of the end of the period.

(3) Average monthly revenue per unit/bed represents the average of the total monthly revenues, excluding amortization of entrance fees, divided by average occupied units/beds.

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(4) Refundable entrance fee sales for the years ended December 31, 2008 and 2007 include amounts received from residents participating in the MyChoice program, which allows new and existing residents the option to pay additional refundable entrance fee amounts in return for a reduced monthly service fee. MyChoice amounts received from existing residents totaled \$0.4 million, \$0.8 million, \$0.6 million and \$0.5 million in the first, second, third and fourth quarters of 2008, respectively, and \$0.2 million, \$3.6 million and \$4.7 million in the second, third and fourth quarters of 2007, respectively. We did not receive any MyChoice amounts from existing residents during the first quarter of 2007.

As of December 31, 2008, our total operations included 548 communities with a capacity to serve 51,804 residents. During 2008, our total portfolio decreased by two communities with our resident capacity decreasing by 282 units as a result of a terminated management agreement and the consolidation of two communities into one.

Our 2008 results were also affected by our continuing implementation of our ancillary services programs at a number of our locations as described above.

Resident Fees

The increase in resident fees occurred across all business segments. Resident fees increased over the prior-year primarily due to an increase in average monthly revenue per unit/bed during the current year which includes an increase in our ancillary services revenue as we continue to roll out therapy and home health services to many of our communities. This increase was partially offset by a decrease in occupancy in the Retirement Centers and CCRCs segments. During the current year, same-store revenues grew 4.4% at the 515 properties we operated in both years with a 6.0% increase in the average monthly revenue per unit/bed and a 1.4% decrease in occupancy.

Retirement Centers revenue increased \$9.5 million, or 1.8%, primarily due to an increase in the average monthly revenue per unit/bed at the communities we operated during both years as well as an increase in revenues related to the expansion of our ancillary service. This increase was partially offset by a decrease in occupancy at our same-store communities year over year.

Assisted Living revenue increased \$46.3 million, or 5.8%, primarily due to an increase in the average monthly revenue per unit/bed at the communities we operated during both years as well as an increase in revenues related to the expansion of our ancillary service programs. Occupancy at our same-store communities was approximately flat year over year.

CCRCs revenue increased \$32.8 million, or 6.5%, primarily due to an increase in the average monthly revenue per unit/bed at the communities we operated during both years as well as an increase in revenues related to the expansion of our ancillary services. This increase was partially offset by a decrease in occupancy at our same-store communities year over year.

Management Fees

Management fees were comparable year over year as the number of management contracts maintained was largely consistent during both years.

Facility Operating Expense

Facility operating expense increased over the prior-year primarily due to an increase in salaries, wages and benefits related to normal salary increases, increased employee hours worked and reduced open positions, as well as an

increase in expenses incurred in connection with the continued rollout of our ancillary services program during the current year.

Retirement Centers operating expenses increased \$14.4 million, or 4.8%, primarily due to an increase in salaries, wages and benefits related to normal salary increases, increased employee hours worked and reduced open positions, \$1.3 million of expense incurred in connection with hurricanes and other named tropical storms, an increase in insurance and utility expenses period over period as well as an increase in expense incurred in connection with the continued rollout of our ancillary services program.

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Assisted Living operating expenses increased \$49.1 million, or 9.5%, due to an increase in salaries, wages and benefits related to normal salary increases, increased employee hours worked and reduced open positions, \$2.0 million of expense incurred in connection with hurricanes and other named tropical storms as well as an increase in expense incurred in connection with the continued rollout of our ancillary services program.

CCRCs operating expenses increased \$27.2 million, or 7.6%, due to an increase in salaries, wages and benefits due to normal salary increases and increased employee count, increased pharmacy, medical, and other health care supplies, as well as \$1.5 million of expense incurred in connection with hurricanes and other named tropical storms.

General and Administrative Expense

General and administrative expense increased \$2.9 million, or 2.1%, primarily as a result of an increase in non-controllable expenses related to the \$8.0 million reserve established for certain litigation during the second quarter (Note 21) and non-cash stock-based compensation expense in connection with restricted stock grants period over period offset by a decrease in integration and merger costs that were significantly higher in the prior year. General and administrative expense as a percentage of total revenue, including revenue generated by the communities we manage, was 4.5% and 5.0% for the years ended December 31, 2008 and 2007, respectively, calculated as follows (dollars in thousands):

	Year Ended December 31,	
	2008	2007
Resident fee revenues	\$ 1,921,060	\$ 1,832,507
Resident fee revenues under management	152,970	150,204
Total	\$ 2,074,030	\$ 1,982,711
General and administrative expenses (excluding merger and integration expenses and non-cash stock compensation expense totaling \$48.4 million and \$39.2 million in 2008 and 2007, respectively)	\$ 92,473	\$ 98,858
General and administrative expenses as % of total revenues	4.5%	5.0%

Facility Lease Expense

Facility lease expense decreased by \$2.2 million, or 0.8%, primarily as a result of lower variable interest rates within certain lease agreements.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$23.7 million, or 7.9%, primarily as a result of resident in-place lease intangibles becoming fully amortized during the year ended December 31, 2008, which was partially offset by an increase in depreciation expense related to depreciation on capital expenditures that we made during the latter part of 2007.

Goodwill and Asset Impairment

During the year we recognized \$220.0 million of impairment charges mainly related to the CCRCs operating segment. The non-cash charges consisted of \$215.0 million of goodwill impairment related to the CCRCs segment and \$5.0 million of asset impairment for property, plant and equipment and leasehold intangibles for certain

communities within the Assisted Living segment. The impairment charge was primarily driven by adverse equity market conditions intensifying in the fourth quarter of 2008 that caused a decrease in current market multiples and our stock price at December 31, 2008 compared with our stock price at September 30, 2008.

Interest Income

Interest income remained relatively constant year over year.

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Interest Expense

Interest expense remained relatively constant period over period. During the year ended December 31, 2008, we recognized approximately \$68.1 million of interest expense on our interest rate swaps due to unfavorable changes in the LIBOR yield curve which resulted in a change in the fair value of the swaps, as compared to approximately \$73.2 million of interest expense on our interest rate swaps for the year ended December 31, 2007. Interest expense incurred on debt remained relatively consistent year over year as interest from additional borrowings was offset by a reduction in interest from refinancing outstanding debt at a more favorable rate as well as the payoff of certain debt during the current year.

Income Taxes

The decrease in the income tax benefit over the same prior year period is due to a decrease in the effective tax rate from 38.4 % in 2007 to 18.9 % in 2008. This decrease is primarily to the impact of the impairment charge taken for financial statement purposes, which is not deductible for tax. The rate was also impacted by the Company's stock based compensation tax deduction as compared to the financial expense for 2008, and for an additional valuation allowance recorded in the year.

Year Ended December 31, 2007 and 2006

The following table sets forth, for the periods indicated, statement of operations items and the amount and percentage of increase or decrease of these items. The results of operations for any particular period are not necessarily indicative of results for any future period. The following data should be read in conjunction with our consolidated financial statements and the notes thereto, which are included herein. Our results reflect the inclusion of acquisitions that occurred during the respective reporting periods. Refer to our Annual Report on Form 10-K for the year ended December 31, 2006, filed March 16, 2007, and the notes to the consolidated financial statements included herein for additional information regarding 2007 and 2006 acquisitions.

Certain prior period amounts have been reclassified to conform to the current year presentation.

(dollars in thousands)	Years Ended December 31,		Increase (Decrease)	
	2007	2006	Amount	Percent
Statement of Operations Data:				
Total revenue				
Resident fees				
Retirement Centers	\$ 532,680	\$ 432,673	\$ 100,007	23.1%
Assisted Living	799,070	614,973	184,097	29.9%
CCRCs	500,757	256,650	244,107	95.1%
Total resident fees	1,832,507	1,304,296	528,211	40.5%
Management fees	6,789	5,617	1,172	20.9%
Total revenue	1,839,296	1,309,913	529,383	40.4%
Expense				
Facility operating expense(1)				
Retirement Centers	299,086	248,062	51,024	20.6%
Assisted Living	514,130	383,987	130,143	33.9%
CCRCs	357,721	187,752	169,969	90.5%
Total facility operating expense	1,170,937	819,801	351,136	42.8%

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General and administrative expense	138,013	117,897	20,116	17.1%
Facility lease expense	271,628	228,779	42,849	18.7%
Depreciation and amortization	299,925	188,129	111,796	59.4%
Total operating expense	1,880,503	1,354,606	525,897	38.8%
Loss from operations	(41,207)	(44,693)	3,486	7.8%
Interest income	7,519	6,810	709	10.4%
Interest expense				
Debt	(143,991)	(97,694)	(46,297)	(47.4%)
Amortization of deferred financing costs	(7,064)	(5,061)	(2,003)	(39.6%)

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Change in fair value of derivatives and amortization	(73,222)	(38)	(73,184)	NM
Loss on extinguishment of debt	(2,683)	(1,526)	(1,157)	(75.8%)
Equity in loss of unconsolidated ventures	(3,386)	(3,705)	319	8.6%
Other non-operating income	402	—	402	100%
Loss before income taxes	(263,632)	(145,907)	(117,725)	(80.7%)
Benefit for income taxes	101,260	38,491	62,769	163.1%
Loss before minority interest	(162,372)	(107,416)	(54,956)	(51.2%)
Minority interest	393	(671)	1,064	158.6%
Net loss	\$ (161,979)	\$ (108,087)	\$ (53,892)	(49.9%)
Selected Operating and Other Data:				
Total number of communities (at end of period)	550	546	4	0.7%
Total units/beds operated(2)	52,086	51,271	815	1.6%
Owned/leased communities units/beds	47,670	46,723	947	2.0%
Owned/leased communities occupancy rate:				
Period end	90.6%	91.1%	(0.5%)	(0.5%)
Weighted average	90.7%	90.4%	0.3%	0.3%
Average monthly revenue per unit/bed(3)	\$ 3,577	\$ 3,247	\$ 330	10.2%
Selected Segment Operating and Other Data				
Retirement Centers				
Number of communities (period end)	87	85	2	2.4%
Total units/beds(2)	15,805	15,556	249	1.6%
Occupancy rate:				
Period end	91.7%	92.4%	(0.7%)	(0.8%)
Weighted average	92.4%	92.4%	—	—
Average monthly revenue per unit/bed(3)	\$ 3,067	\$ 2,864	\$ 203	7.1%
Assisted Living				
Number of communities (period end)	409	405	4	1.0%
Total units/beds(2)	21,012	20,687	325	1.6%
Occupancy rate:				
Period end	89.7%	89.7%	—	—
Weighted average	89.7%	89.7%	—	—
Average monthly revenue per unit/bed(3)	\$ 3,537	\$ 3,285	\$ 252	7.7%
CCRCs				
Number of communities (period end)	32	32	—	—
Total units/beds(2)	10,853	10,480	373	3.6%
Occupancy rate:				
Period end	90.8%	91.9%	(1.1%)	(1.2%)
Weighted average	90.0%	88.2%	1.8%	2.0%
Average monthly revenue per unit/bed(3)	\$ 4,481	\$ 4,048	\$ 433	10.7%
Management Services				
Number of communities (period end)	22	24	(2)	(8.3%)
Total units/beds(2)	4,416	4,548	(132)	(2.9%)
Occupancy rate:				
Period end	83.1%	92.6%	(9.5%)	(10.3%)
Weighted average	87.1%	92.3%	(5.2%)	(5.6%)

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Selected Entrance Fee Data:

	2007					
	Q1	Q2	Q3	Q4	YTD	
Non-refundable entrance fees sales	\$ 3,916	\$ 4,726	\$ 5,673	\$ 5,015	\$ 19,330	
Refundable entrance fees sales(4)	4,258	4,064	8,696	8,901	25,919	
Total entrance fee receipts	8,174	8,790	14,369	13,916	45,249	
Refunds	(6,315)	(4,089)	(5,084)	(4,069)	(19,557)	
Net entrance fees	\$ 1,859	\$ 4,701	\$ 9,285	\$ 9,847	\$ 25,692	
	2006					
	Q1	Q2	Q3	Q4	YTD	
Non-refundable entrance fees sales	\$ 448	\$ 165	\$ 3,716	\$ 8,467	\$ 12,796	
Refundable entrance fees sales	1,621	1,135	4,144	7,860	14,760	
Total entrance fee receipts	2,069	1,300	7,860	16,327	27,556	
Refunds	(703)	(308)	(3,529)	(4,648)	(9,188)	
Net entrance fees	\$ 1,366	\$ 992	\$ 4,331	\$ 11,679	\$ 18,368	

(1) Facility operating expense for the year ended December 31, 2007 includes \$7.0 million of charges comprised of \$5.9 million of estimated uncollectible accounts and \$1.1 million of accounting conformity adjustments pertaining to inventory and certain accrual policies.

(2) Total units/beds operated represent the total units/beds operated as of the end of the period.

(3) Average monthly revenue per unit/bed represents the average of the total monthly revenues, excluding amortization of entrance fees, divided by average occupied units/beds.

(4) Refundable entrance fee sales for the year ended December 31, 2007 include amounts received from residents participating in the MyChoice program, which allows new and existing residents the option to pay additional refundable entrance fee amounts in return for a reduced monthly service fee. MyChoice amounts received from existing residents totaled \$0.2 million, \$3.6 million and \$4.7 million in the second, third and fourth quarters of 2007, respectively. We did not receive any MyChoice amounts from existing residents during the first quarter of 2007 or in 2006.

As of December 31, 2007, our total operations included 550 communities with a capacity to serve 52,086 residents. During 2007, our total portfolio grew by three communities and our resident capacity increased by 815 units. During 2007, we focused substantial resources on furthering the integration of the communities that we acquired during 2006.

Our 2007 results were also affected by our continuing implementation of our ancillary services programs at a number of our locations as described above.

Resident Fees

The increase in resident fees was driven by revenue growth across all business segments. Resident fees increased over the prior-year primarily due to the number of acquisitions that we completed during 2006 and 2007, as resident fees from these acquisitions are partially or entirely excluded from the prior period results. Including the effect of the historical results of the ARC facilities only partially included in our results of operations in 2006, resident fees increased by approximately \$94.4 million, or 6.9%, at the 425 communities we operated during both periods, driven

primarily by an increase of 6.9% in the average monthly revenue per unit/bed. Average occupancy at these 425 communities was 90.9% in 2007 and 2006.

Retirement Centers revenue increased \$100.0 million, or 23.1%, primarily due to the inclusion of facilities acquired during 2006 and 2007, as resident fees from these acquisitions are partially or entirely excluded from the prior period results. Revenue growth was also impacted by an increase in the average monthly revenue per

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unit/bed at the facilities we operated during both periods. Occupancy at these facilities remained fairly constant period over period.

Assisted Living revenue increased \$184.1 million, or 29.9%, primarily due to the 2006 and 2007 acquisitions. In addition, resident fees increased as a result of an increase in the average monthly revenue per unit/bed, coupled with relatively constant occupancy as compared to the same period in the prior-year.

CCRCs revenue increased \$244.1 million, or 95.1%, primarily due to the acquisition of ARC in the third quarter of 2006.

Management Fees

The increase in management fees over the prior-year is primarily due to the acquisition of management contracts in conjunction with the ARC acquisition in July 2006. The increase is partially offset by the termination of ten management agreements during 2006.

Facility Operating Expense

Facility operating expense increased over the prior-year same period mainly due to the ARC acquisition as well as other 2006 and 2007 acquisitions. The increase was primarily due to additional salaries, wages and benefits resulting from these acquisitions. In addition, for the quarter ended December 31, 2007, we recorded \$7.0 million of charges to facility operating expenses comprised of \$5.9 million of estimated uncollectible accounts, and \$1.1 million of accounting conformity adjustments pertaining to inventory and certain accrual policies. Including the effect of the historical results of the ARC facilities only partially included in our results of operations in 2006, facility operating expense increased by 6.5% at the 425 communities we operated in both periods.

Retirement Centers operating expenses increased \$51.0 million, or 20.6%, primarily due to increased salaries, wages and benefits primarily as a result of the 2006 acquisitions and additional 2007 acquisitions.

Assisted Living operating expenses increased \$130.1 million, or 33.9%, primarily due to increased salaries, wages and benefits primarily as a result of the 2006 acquisitions and additional 2007 acquisitions.

CCRCs operating expenses increased \$170.0 million, or 90.5%, primarily due to the 2006 acquisition of ARC.

General and Administrative Expense

General and administrative expenses increased \$20.1 million, or 17.1%, primarily as a result of an increase in salaries, wages and benefits due to an increase in the number of employees in connection with the 2006 acquisition of ARC. Additionally, general and administrative expense was positively impacted during the year by a receivable related to a collateral recovery of \$4.2 million from an insurance carrier recorded in the second quarter which was largely offset by other insurance activity and a decrease of \$6.5 million in non-cash compensation expense in connection with previously expensed performance-based restricted stock grants. General and administrative expense as a percentage of total revenue, including revenue generated by the facilities we manage, was 5.0% and 5.4% for the year ended December 31, 2007 and 2006, calculated as follows (dollars in thousands):

Year Ended December 31,	
2007	2006

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Resident fee revenues	\$ 1,832,507	\$ 1,304,296
Resident fee revenues under management	150,204	73,507
Total	\$ 1,982,711	\$ 1,377,803
General and administrative expenses (excluding merger and integration expenses and non-cash stock compensation expense totaling \$39.2 million and \$43.4 million in 2007 and 2006, respectively)		
	\$ 98,858	\$ 74,449
General and administrative expenses as % of total revenues	5.0%	5.4%

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Facility Lease Expense

Lease expense increased by \$42.8 million, or 18.7%, primarily due to the ARC acquisition in July 2006 as well as other 2006 and 2007 acquisitions and expense increases based on rent escalators included in the lease agreements. The increase in expense is partially offset by a decrease in lease expense resulting from the purchase of previously leased assets in the fourth quarter of 2006. Lease expense includes straight-line rent expense of \$25.4 million and \$24.7 million for the years ended December 31, 2007 and 2006, respectively, and is partially offset by \$4.3 million of additional deferred gain amortization for both periods.

Depreciation and Amortization

Total depreciation and amortization expense increased by \$111.8 million, or 59.4%, primarily due to the acquisition of ARC as well as other 2006 and 2007 acquisitions. The increase was partially offset by a decrease in expense for resident in-place lease intangibles which were fully depreciated at the end of 2006.

Interest Income

Interest income increased \$0.7 million, or 10.4%, primarily due to the acquisition of ARC in July 2006.

Interest Expense

Interest expense increased \$121.5 million, or 118.2%, primarily due to additional debt incurred in connection with our acquisitions as well as the change in fair value of our interest rate swaps for the year ended December 31, 2007. During the year, we recognized approximately \$73.2 million of interest expense related to the change in fair value and amortization of our interest rate swaps due to declines in the LIBOR yield curve which resulted in a change in the fair value of the swaps. We have entered into certain interest rate protection and swap agreements to effectively cap or convert floating rate debt to fixed rate. Pursuant to certain of our hedge agreements, we are required to secure our obligation to the counterparty by posting cash or other collateral if the fair value liability exceeds specified thresholds. In periods of significant volatility in the credit markets, the value of these swaps can change significantly. The effective portion of the change in fair value of derivatives was excluded from interest expense and was included in other comprehensive loss for the nine months ended September 30, 2006. On October 1, 2006, we discontinued hedge accounting and the changes in fair value of derivatives have been included in interest expense prospectively.

Income Taxes

The increase in the income tax benefit over the same prior year period is due to an increase in the effective tax rate from 26.4% in 2006 to 38.4% in 2007. This increase is primarily due to the ability of the Company to record a tax benefit on its entire 2007 loss, compared to benefiting the losses in 2006 after the acquisition of ARC, which occurred in July 2006.

Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States, or GAAP, requires us to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses. We consider an accounting estimate to be critical if it requires assumptions to be made that were uncertain at the time the estimate was made and changes in the estimate, or different estimates that could have been selected, could have a material impact on our consolidated results of operations or financial

condition. We have identified the following critical accounting policies that affect significant estimates and judgments.

Revenue Recognition and Assumptions at Entrance Fee Communities

Our ten entrance fee communities provide housing and healthcare services through entrance fee agreements with residents. Under certain of these agreements, residents pay an entrance fee upon entering into the contract and are contractually guaranteed certain limited lifecare benefits in the form of healthcare discounts. The recognition of entrance fee income requires the use of various actuarial estimates. We recognize this revenue by recording the

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nonrefundable portion of the residents' entrance fees as deferred entrance fee income and amortizing it into revenue using the straight-line method over the estimated remaining life expectancy of each resident or couple. In addition, certain entrance fee agreements entitle the resident to a refund of the original entrance fee paid plus a percentage of the appreciation of the unit contingent upon resale. We estimate the portion of such entrance fees that will be repaid to the resident from other contingently refundable entrance fees received or non-refundable entrance fees received and record that portion as deferred revenue with the remainder classified as refundable entrance fees. The portion recorded as deferred revenue is amortized over the life of the entrance fee building. We periodically assess the reasonableness of these mortality tables and other actuarial assumptions, and measurement of future service obligations.

Obligation to Provide Future Services

Annually, we calculate the present value of the net cost of future services and the use of communities to be provided to current residents of certain of our CCRCs and compare that amount with the balance of non-refundable deferred revenue from entrance fees received. If the present value of the net cost of future services and the use of communities exceeds the non-refundable deferred revenue from entrance fees, a liability is recorded (obligation to provide future services and use of communities) with a corresponding charge to income.

Self-Insurance Liability Accruals

We are subject to various legal proceedings and claims that arise in the ordinary course of our business. Although we maintain general liability and professional liability insurance policies for our owned, leased and managed communities under a master insurance program, our current policy provides for deductibles for each and every claim (\$3.0 million on or prior to December 31, 2008 and \$250,000 effective January 1, 2009). The amount of liquid assets available to satisfy these deductible obligations is \$10.9 million (classified as cash and escrow deposits – restricted in the consolidated balance sheets). As a result, we are effectively self-insured for most claims. In addition, we maintain a self-insured workers compensation program (with excess loss coverage above \$0.5 million per individual claim) and a self-insured employee medical program (with excess loss coverage above \$0.3 million per individual claim). We are self-insured for amounts below these excess loss coverage amounts. We have formed a wholly-owned “captive” insurance company, Senior Services Insurance Limited (“SSIL”) for the purpose of insuring certain portions of our risk retention under our general and professional liability insurance programs. SSIL issues policies of insurance to and receives premiums from Brookdale Senior Living Inc. that are reimbursed through expense allocation to each operated community and us. SSIL pays the costs for each claim above a deductible up to a per claim limit. Third-party insurers are responsible for claim costs above this limit. These third-party insurers carry an A.M. Best rating of A-/VII or better.

The cost of our employee health and dental benefits, net of employee contributions, is shared by us and our communities based on the respective number of participants working directly either at our corporate headquarters or at the communities. Cash received is used to pay the actual costs of administering the program which include paid claims, third-party administrative fees, network provider fees, communication costs, and other related administrative costs incurred by us. Claims are paid as they are submitted to the plan administrator.

Outstanding losses and expenses for general liability and professional liability and workers compensation are based on the recommendations of independent actuaries and management's estimates. Outstanding losses and expenses for our self-insured medical program are estimated based on the recommendation of our third party administrator.

We review the adequacy of our accruals related to these liabilities on an ongoing basis, using historical claims, actuarial valuations, third-party administrator estimates, consultants, advice from legal counsel and industry data, and

adjust accruals periodically. Estimated costs related to these self-insurance programs are accrued based on known claims and projected claims incurred but not yet reported. Subsequent changes in actual experience are monitored and estimates are updated as information is available.

Income Taxes

We account for income taxes under the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 109, Accounting for Income Taxes. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using tax rates in effect for

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the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts that are expected to be realized. As of December 31, 2008 and 2007, we have a valuation allowance against deferred tax assets of approximately \$9.7 million and \$6.4 million, respectively. When we determine that it is more likely than not that we will be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the deferred tax asset would be made and reflected in either income or as an adjustment to goodwill. This determination will be made by considering various factors, including our expected future results, that in our judgment will make it more likely than not that these deferred tax assets will be realized.

Lease Accounting

We determine whether to account for our leases as either operating or capital leases depending on the underlying terms. As of December 31, 2008, we operated 358 communities under long-term leases with operating, capital and financing lease obligations. The determination of this classification is complex and in certain situations requires a significant level of judgment. Our classification criteria is based on estimates regarding the fair value of the leased communities, minimum lease payments, effective cost of funds, the economic life of the community and certain other terms in the lease agreements as stated in our consolidated financial statements included elsewhere in this Annual Report on Form 10-K. Communities under operating leases are accounted for in our statement of operations as lease expenses for actual rent paid plus or minus straight-line adjustments for fixed or estimated minimum lease escalators and amortization of deferred gains. For communities under capital lease and lease financing obligation arrangements, a liability is established on our balance sheet and a corresponding long-term asset is recorded. Lease payments are allocated between principal and interest on the remaining base lease obligations and the lease asset is depreciated over the shorter of its useful life or the term of the lease. In addition, we amortize leasehold improvements purchased during the term of the lease over the shorter of their economic life or the lease term. Sale-leaseback transactions are recorded as lease financing obligations when the transactions include a form of continuing involvement, such as purchase options.

One of our leases provides for various additional lease payments based on changes in the interest rates on the debt underlying the lease. All of our leases contain fixed or formula based rent escalators. To the extent that the escalator increases are tied to a fixed index or rate, lease payments are accounted for on a straight-line basis over the life of the lease. In addition, we recognize all rent-free or rent holiday periods in operating leases on a straight-line basis over the lease term, including the rent holiday period.

Allowance for Doubtful Accounts

Accounts receivable are reported net of an allowance for doubtful accounts, and represent our estimate of the amount that ultimately will be realized in cash. The allowance for doubtful accounts was \$13.3 million, and \$15.5 million as of December 31, 2008 and 2007, respectively. The adequacy of our allowance for doubtful accounts is reviewed on an ongoing basis, using historical payment trends, write-off experience, analyses of receivable portfolios by payor source and aging of receivables, as well as a review of specific accounts, and adjustments are made to the allowance as necessary. Changes in legislation are not expected to have a material impact on collections; however, changes in economic conditions could have an impact on the collection of existing receivable balances or future allowance considerations.

Approximately 86.2% and 13.8% of our resident and healthcare revenues for the year ended December 31, 2008 were derived from private pay customers and services covered by various third-party payor programs, including Medicare and Medicaid. Billings for services under third-party payor programs are recorded net of estimated retroactive adjustments, if any, under reimbursement programs. Retroactive adjustments are accrued on an estimated basis in the

period the related services are rendered and adjusted in future periods or as final settlements are determined. We accrue contractual or cost related adjustments from Medicare or Medicaid when assessed (without regard to when the assessment is paid or withheld), even if we have not agreed to or are appealing the assessment. Subsequent positive or negative adjustments to these accrued amounts are recorded in net revenues when known.

Long-Lived Assets, Goodwill and Purchase Accounting

As of December 31, 2008 and 2007, our long-lived assets were comprised primarily of \$3.7 billion and \$3.8 billion, respectively, of property, plant and equipment and leasehold intangibles. In accounting for our long-lived

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assets, other than goodwill, we apply the provisions of SFAS No. 141, Business Combinations, and SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (“SFAS 144”). In connection with our formation transactions, for financial reporting purposes we recorded the non-controlling stockholders’ interest at fair value. Acquisitions are accounted for using the purchase method of accounting and the purchase prices are allocated to acquired assets and liabilities based on their estimated fair values. Goodwill associated with our acquisition of ARC and our formation transactions was allocated to the reportable segment and included in our application of the provisions of SFAS No. 142, Goodwill and Other Intangible Assets (“SFAS 142”). We account for goodwill under the provisions of SFAS 142. During the year ended December 31, 2008, we recorded a \$215.0 million goodwill impairment charge in connection with our annual impairment test. The impairment charge was primarily driven by adverse equity market conditions intensifying in the fourth quarter of 2008 that caused a decrease in current market multiples and our stock price at December 31, 2008 compared with our stock price at September 30, 2008. We also evaluated the related long-lived depreciable assets using the same cash flow data used to evaluate goodwill and determined that the undiscounted cash flows exceeded the carrying value of these assets for all except for four communities. As a result, we recorded a non-cash asset impairment charge of \$5.0 million for the quarter ended December 31, 2008 for these four communities within the Assisted Living segment. As of December 31, 2008 and 2007, we had \$110.0 million and \$325.5 million of goodwill, respectively.

We test long-lived assets other than goodwill for recoverability annually during our fourth quarter or whenever changes in circumstances indicate the carrying value may not be recoverable. Recoverability of an asset group is estimated by comparing its carrying value to the future net undiscounted cash flows expected to be generated by the asset group. If this comparison indicates that the carrying value of an asset group is not recoverable, we are required to recognize an impairment loss. The impairment loss is measured by the amount by which the carrying amount of the asset group exceeds its estimated fair value. When an impairment loss is recognized for assets to be held and used, the carrying amount of those assets is permanently adjusted and depreciated over its remaining useful life.

Goodwill is not amortized, but is subject to annual or more frequent impairment testing. We test goodwill for impairment annually during our fourth quarter, or whenever indicators exist that our goodwill may not be recoverable. The recoverability of goodwill is required to be assessed using a two-step process. The first step requires a comparison of the estimated fair value of a reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its estimated fair value, the second step requires a comparison of the implied fair value of goodwill (based on a putative purchase price allocation methodology) with its carrying value. If the carrying value of the reporting unit’s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess.

In estimating the fair value of a reporting unit or long-lived assets other than goodwill, we use the income approach. The income approach utilizes future cash flow projections that are developed internally. Any estimates of future cash flow projections necessarily involve predicting an unknown future and require significant management judgments and estimates. In arriving at our cash flow projections, we consider our historic operating results, approved budgets and business plans, future demographic factors, expected growth rates, and other factors. Future events may indicate differences from management’s current judgments and estimates, which could, in turn, result in future impairments. Future events that may result in impairment charges include increases in interest rates, which could impact discount rates, differences in the projected occupancy rates and changes in the cost structure of existing communities.

In using the income approach to estimate fair value of a reporting unit or long-lived assets other than goodwill, we make certain key assumptions. Those assumptions include assumptions related to future revenues, future facility operating expenses, future cash flows that we would receive upon a future sale of the communities using estimated cap rates. We attempt to corroborate the cap rates we use in these calculations with cap rates observable from recent

market transactions.

Where required, future cash flows are discounted at a rate that is consistent with a weighted average cost of capital for a potential market participant. The weighted average cost of capital is an estimate of the overall after-tax rate of return required by equity and debt holders of a business enterprise.

Although we make every reasonable effort to ensure the accuracy of our estimate of the fair value of our reporting units, future changes in the assumptions used to make these estimates could result in the recording of an impairment loss.

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Hedging

We periodically enter into certain interest rate swap or cap agreements to effectively convert floating rate debt to a fixed rate basis or to hedge anticipated future financings. Amounts paid or received under these agreements are recognized as an adjustment to interest expense when such amounts are incurred or earned. For effective cash flow hedges, settlement amounts paid or received in connection with settled or unwound interest rate swap agreements are deferred and recorded to accumulated other comprehensive income. For effective fair value hedges, changes in the fair value of the derivative will be offset against the corresponding change in fair value of the hedged asset or liability through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be recognized in earnings. All derivative instruments are recorded at fair value. Derivatives that do not qualify for hedge accounting are recorded at fair value through earnings.

On October 1, 2006, we elected to discontinue hedge accounting prospectively for the previously designated swap instruments. Consequently, the net gain accumulated in other comprehensive income at that date of approximately \$1.3 million related to the previously designated swap instruments is being reclassified to interest expense over the life of the underlying hedged debt. In the future, if the underlying hedged debt is extinguished or refinanced, the remaining unamortized gain or loss in accumulated other comprehensive income will be recognized in net income.

In measuring our derivative instruments at fair value, we have considered nonperformance risk in our valuation. In so doing, we review the netting arrangement and collateral requirements of each instrument and counterparty to determine appropriate reductions of credit exposure. Remaining credit exposure is estimated by reference to market prices for credit default swaps and/or other methods of estimating probabilities of default.

Stock-Based Compensation

We adopted SFAS No. 123 (revised), Share-Based Payment ("SFAS No. 123R"), in connection with initial grants of restricted stock effective August 2005, which were converted into shares of our restricted stock on September 30, 2005 in connection with our formation transaction. This Statement requires measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock awards. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized when incurred.

Certain of our employee stock awards vest only upon the achievement of performance targets. SFAS No. 123R requires recognition of compensation cost only when achievement of performance conditions is considered probable. Consequently, our determination of the amount of stock compensation expense requires a significant level of judgment in estimating the probability of achievement of these performance targets. Additionally, we must make estimates regarding employee forfeitures in determining compensation expense. Subsequent changes in actual experience are monitored and estimates are updated as information is available.

Litigation

Litigation is inherently uncertain and the outcome of individual litigation matters is not predictable with assurance. We are involved in various legal actions and claims incidental to the conduct of our business which are comparable to other companies in the senior living industry, some for specific matters as described in Note 21 to the consolidated financial statements and others arising in the ordinary course of business. We have established loss provisions for matters in which losses are probable and can be reasonably estimated. In other instances, we may not be able to make a reasonable estimate of any liability because of uncertainties related to the outcome and/or the amount or range of losses. Changes in our current estimates, due to unanticipated events or otherwise, could have a material

impact on our financial condition and results of operations.

New Accounting Pronouncements

The information required by this Item is provided in Note 2 of the notes to the consolidated financial statements contained in “Item 8. Financial Statements and Supplementary Data”.

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Liquidity and Capital Resources

The following is a summary of cash flows from operating, investing and financing activities, as reflected in the Consolidated Statements of Cash Flows (dollars in thousands):

	Year Ended December 31,	
	2008	2007
Cash provided by operating activities	\$ 136,767	\$ 199,662
Cash used in investing activities	(166,439)	(358,419)
Cash (used in) provided by financing activities	(17,259)	191,627
Net (decrease) increase in cash and cash equivalents	(46,931)	32,870
Cash and cash equivalents at beginning of period	100,904	68,034
Cash and cash equivalents at end of period	\$ 53,973	\$ 100,904

The decrease in cash provided by operating activities was attributable to an increase in accounts receivable due to the timing of billings and payments and an increase in billings in conjunction with the rollout of our therapy and home health services to many of our communities. Also contributing to the decrease was an increase in prepaid expenses and other assets offset by a decrease in working capital year over year.

The decrease in cash used in investing activities was primarily attributable to a decrease in acquisition activity in the current year as well as cash received on outstanding notes receivable. This decrease was partially offset by an increase in additions to our property, plant and equipment and leasehold intangibles year over year.

The change in cash related to financing activities year over year was primarily attributable to a decrease in borrowings in the current year and an increase in repayments on debt related to financing activities partially offset by a decrease in the payment of dividends in the current year and the buyout of a capital lease in the prior year. Additionally, during the year ended December 31, 2008, we repurchased 1,211,301 shares of our common stock at an aggregate cost of \$29.2 million.

Our principal sources of liquidity have historically been from:

- cash balances on hand;
- cash flows from operations;
- proceeds from our credit facilities;
- proceeds from mortgage financing or refinancing of various assets;
- funds generated through joint venture arrangements or sale-leaseback transactions; and
- with somewhat lesser frequency, funds raised in the debt or equity markets and proceeds from the selective disposition of underperforming assets.

Over the longer-term, we expect to continue to fund our business through these principal sources of liquidity. Over the near-term, however, we expect a reduced level of mortgage refinancing activity. As described under "Credit Facilities" below, the revolving loan commitment under our amended credit agreement decreases on a quarterly basis beginning March 31, 2009. As such, we anticipate a reduced level of reliance on proceeds from our credit facility over the near-term compared to historical levels. In addition, given current conditions in the credit and equity markets, we also expect a reduced level of debt and equity financing activity over the near-term when compared to historical levels.

Our liquidity requirements have historically arisen from:

- working capital;
- operating costs such as employee compensation and related benefits, general and administrative expense and supply costs;
- debt service and lease payments;
- acquisition consideration and transaction costs;
- cash collateral required to be posted in connection with our interest rate swaps and related financial instruments;

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- capital expenditures and improvements, including the expansion of our current communities and the development of new communities;
- dividend payments;
- purchases of common stock under our previous share repurchase authorization; and
- other corporate initiatives (including integration and branding).

Over the near-term, we expect that our liquidity requirements will primarily arise from:

- working capital;
- operating costs such as employee compensation and related benefits, general and administrative expense and supply costs;
- debt service and lease payments;
- capital expenditures and improvements, including the expansion of our current communities and the development of new communities;
- other corporate initiatives (including integration); and
- to a lesser extent, cash collateral required to be posted in connection with our interest rate swaps and related financial instruments.

We are highly leveraged, and have significant debt and lease obligations. We have two principal corporate-level indebtednesses: our \$230.0 million amended credit facility and our unsecured facilities providing for up to \$48.5 million of letters of credit in the aggregate. The remainder of our indebtedness is generally comprised of non-recourse property-level mortgage financings.

At December 31, 2008, we had \$2.1 billion of debt outstanding, excluding our line of credit and capital lease obligations, at a weighted-average interest rate of 4.91%. At December 31, 2008, we had \$318.4 million of capital and financing lease obligations, \$159.5 million was drawn on our revolving loan facility and \$149.7 million of letters of credit had been issued under our letter of credit facilities. Approximately \$158.5 million of our debt obligations (excluding the \$4.5 million current portion of our line of credit) are due on or before December 31, 2009, subject in the case of debt obligations totaling \$131.0 million to extension at our option, as described below under “Contractual Commitments”. We also have substantial operating lease obligations and capital expenditure requirements. For the year ending December 31, 2009, we will be required to make approximately \$261.9 million of payments in connection with our existing operating leases.

We had \$54.0 million of cash and cash equivalents at December 31, 2008, excluding cash and escrow deposits-restricted and lease security deposits of \$136.3 million. Additionally, as of December 31, 2008, we had \$41.4 million available under our corporate credit facility and \$16.9 million of unused capacity under our letter of credit facilities.

As of December 31, 2008, we had \$158.5 million of current debt maturities (excluding the \$4.5 million current portion of our line of credit) and \$107.2 million of letters of credit issued under facilities that were scheduled to mature prior to December 31, 2009. After giving effect to our amended credit agreement, our \$48.5 million unsecured letter of credit facilities, and the extension in early 2009 of \$87.7 million of mortgage debt that was initially due in 2009 until 2011, we have approximately \$139.6 million of debt maturities due during the year ending December 31, 2009, comprised of the following: non-recourse mortgage debt maturities of \$131.0 million, which we expect will be extended to 2011 pursuant to the exercise of contractual extension options, and \$8.6 million of scheduled periodic principal amortization and other required principal payments.

At December 31, 2008, we had \$365.2 million of negative working capital, which includes the classification of \$206.5 million of refundable entrance fees, \$30.0 million in tenant deposits and \$131.0 million of debt for which we have extension rights as current liabilities. Based upon our historical operating experience, we anticipate that only 9.0 % to 12.0% of those entrance fee liabilities will actually come due, and be required to be settled in cash, during the next 12 months. We expect that any entrance fee liabilities due within the next 12 months will be fully offset by the proceeds generated by subsequent entrance fee sales. Entrance fee sales, net of refunds paid, provided \$23.3 million of cash for the year ended December 31, 2008.

For the year ending December 31, 2009, we anticipate that we will make investments of approximately \$60.0 million for capital expenditures (net of approximately \$108.0 million expected to be reimbursed from lenders/lessors or funded through construction financing), comprised of approximately \$25.0 million of net

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recurring capital expenditures, approximately \$5.0 million of net capital expenditures in connection with our community expansion and development program, and approximately \$30.0 million of expenditures relating to other major projects (including corporate initiatives). These major projects include unusual or non-recurring capital projects, projects which create new or enhanced economics, such as major renovations or repositioning projects at our communities (including deferred expenditures in connection with recently acquired communities), integration related expenditures, and expenditures supporting the expansion of our ancillary services programs. For the year ended December 31, 2008, we spent approximately \$27.3 million for net recurring capital expenditures, approximately \$39.9 million for capital expenditures in connection with our expansion and development program (net of \$65.6 million that had been reimbursed as of December 31, 2008) and approximately \$53.5 million for expenditures relating to other major projects and corporate initiatives.

During 2009, we anticipate funding the majority of capital expenditures relating to our expansion and development program through debt and lease financings for those projects (approximately \$108.0 million in the aggregate). We expect that our other capital expenditures will be funded from cash on hand, cash flows from operations, and amounts drawn on our credit facility.

Through 2007, we focused on growth primarily through acquisition, spending approximately \$2.2 billion during 2007 and 2006 on acquiring communities and companies, excluding fees, expenses and assumption of debt. Given the current market environment and limitations imposed by our new credit facility, we are focusing on integrating previous acquisitions and on the significant organic growth opportunities inherent in our growth strategy. Consequently, we expect a reduced level of acquisition activity and spending over the near term. Over the longer-term, we plan to take advantage of the fragmented continuing care, independent living and assisted living sectors by selectively purchasing existing operating companies, asset portfolios and communities.

In the normal course of business, we use a variety of financial instruments to mitigate interest rate risk. We have entered into certain interest rate protection and swap agreements to effectively cap or convert floating rate debt to a fixed rate basis. Pursuant to certain of our hedge agreements, we are required to secure our obligation to the counterparty by posting cash or other collateral if the fair value liability exceeds specified thresholds. In periods of significant volatility in the credit markets, the value of these swaps can change significantly and as a result, the amount of collateral we are required to post can change significantly. During 2008, we posted approximately \$39.0 million of cash collateral pursuant to interest rate swaps. We have recently taken a number of steps to reduce this risk. In particular, during 2008, we terminated a number of interest rate swaps with an aggregate notional amount of \$1.1 billion and purchased \$445.2 million in aggregate notional amount of interest rate caps, which do not require the posting of cash collateral. Furthermore, during 2008, we obtained \$37.6 million of swaps that are secured by underlying mortgaged assets and, hence, do not require cash collateralization. As of December 31, 2008, we have \$670.5 million in aggregate notional amount of interest rate caps, \$37.6 million in aggregate notional amount of swaps secured by underlying mortgaged assets, \$314.2 million in aggregate notional amount of swaps that require cash collateralization and \$119.8 million of variable rate debt that is not subject to any cap or swap agreements.

We expect to continue to assess our financing alternatives periodically and access the capital markets opportunistically. If our existing resources are insufficient to satisfy our liquidity requirements, or if we enter into an acquisition or strategic arrangement with another company, we may need to sell additional equity or debt securities. Any such sale of additional equity securities will dilute the interests of our existing stockholders, and we cannot be certain that additional public or private financing will be available in amounts or on terms acceptable to us, if at all (particularly given current market conditions). If we are unable to obtain this additional financing, we may be required to delay, reduce the scope of, or eliminate one or more aspects of our business development activities, any of which could reduce the growth of our business.

In light of the current uncertainty in the credit market and the deteriorating overall economy, we are taking steps to preserve our liquidity during 2009. For example, we have suspended our quarterly dividend payments, terminated our share repurchase program and initiated a number of cost control measures (including limitations on our capital expenditures). We currently estimate that our existing cash flows from operations, together with existing working capital, amounts drawn under our credit facility and, to a lesser extent, proceeds from anticipated refinancings of various assets, will be sufficient to fund our liquidity needs for at least the next 12 months, assuming that the overall economy does not substantially deteriorate further.

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Our actual liquidity and capital funding requirements depend on numerous factors, including our operating results, the actual level of capital expenditures, our expansion, development and acquisition activity, general economic conditions and the cost of capital. Shortfalls in cash flows from operating results or other principal sources of liquidity may have an adverse impact on our ability to execute our business and growth strategies. The current volatility in the credit and financial markets may also have an adverse impact on our liquidity by making it more difficult for us to obtain financing or refinancing. As a result, this may impact our ability to grow our business, maintain capital spending levels, expand certain communities, or execute other aspects of our business strategy. In order to continue some of these activities at historical or planned levels, we may incur additional indebtedness or lease financing to provide additional funding. There can be no assurance that any such additional financing will be available or on terms that are acceptable to us (particularly in light of current adverse conditions in the credit market).

As of December 31, 2008, we are in compliance with the financial covenants of our outstanding debt and lease agreements.

Credit Facilities

As of December 31, 2008, we had an available secured line of credit of \$245.0 million (including a \$70.0 million letter of credit sublimit), an associated letter of credit facility of up to \$80.0 million, and separate letter of credit facilities of up to \$42.5 million in the aggregate. The line of credit bore interest at the base rate plus 3.0% or LIBOR plus 4.0%, at our election, and was scheduled to mature on May 15, 2009. We were required to pay fees ranging from 2.5% to 4.0% of the amount of any outstanding letters of credit issued under the associated letter of credit facility and are required to pay a fee of 2.5% of the amount of any outstanding letters of credit issued under the separate letter of credit facilities.

As of December 31, 2008, \$159.5 million was drawn on the revolving loan facility and \$149.7 million of letters of credit had been issued under our letter of credit facilities. Included in the \$149.7 million of letters of credit outstanding at December 31, 2008 is \$32.2 million of duplicative letters of credit posted with counterparties that were in process of being returned. As of February 27, 2009, these duplicative letters of credit were returned and are no longer outstanding.

Refinancing of Existing Line of Credit

We recently refinanced our line of credit by (i) entering into unsecured facilities with a financial institution providing for up to \$48.5 million of letters of credit in the aggregate and (ii) entering into a Second Amended and Restated Credit Agreement with Bank of America, N.A., as administrative agent, Banc of America Securities LLC, as sole lead arranger and book manager, and the several lenders from time to time parties thereto. The amended credit agreement amended and restated our existing \$245.0 million secured line of credit and terminated the associated \$80.0 million letter of credit facility.

The amended credit agreement consists of a \$230.0 million revolving loan facility with a \$25.0 million letter of credit sublimit and is scheduled to mature on August 31, 2010. Pursuant to the terms of the amended credit agreement, we will be required to make mandatory prepayments of (a) 65% of our Excess Cash Flow (as defined in the amended credit agreement) for each fiscal quarter beginning with the first fiscal quarter of 2009, (b) 85% of our net cash proceeds from refinancings, (c) 100% of our net cash proceeds from the issuance of equity (subject to certain exceptions), and (d) 100% of our net cash proceeds from asset dispositions (subject to certain exceptions and limited to 85% in the case of sale-leaseback transactions and dispositions of joint venture interests). The revolving loan commitment will be permanently reduced in a corresponding amount in connection with each mandatory prepayment, provided the commitment reduction with respect to any issuance of equity is limited to 65% of such net cash

proceeds. To the extent that the revolving loan commitment has not been permanently reduced either voluntarily or as a result of mandatory prepayments, the revolving loan commitment will be further reduced as of the dates below to the following aggregate amounts:

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March 31, 2009	\$220.0 million
June 30, 2009	\$200.0 million
September 30, 2009	\$180.0 million
December 31, 2009	\$155.0 million
March 31, 2010	\$130.0 million
June 30, 2010	\$75.0 million

Pursuant to the terms of the amended credit agreement, certain of our subsidiaries, as guarantors, will guarantee our obligations under the amended credit agreement and the other loan documents. Further, in connection with the amended credit agreement, (i) the company and certain guarantors executed and delivered a Pledge Agreement in favor of the administrative agent for the banks and other financial institutions from time to time parties to the amended credit agreement, pursuant to which such guarantors pledged certain assets for the benefit of the secured parties as collateral security for the payment and performance of our obligations under the amended credit agreement and the other loan documents and (ii) certain guarantors granted mortgages and executed and delivered a Security Agreement, in each case, in favor of the administrative agent for the banks and other financial institutions from time to time parties to the amended credit agreement encumbering certain real and personal property of such guarantors. The collateral includes, among other things, certain real property and related personal property owned by the guarantors, equity interests in certain of our subsidiaries, all related books and records and, to the extent not otherwise included, all proceeds and products of any and all of the foregoing.

At our option, amounts drawn under the revolving loan facility will generally bear interest at either (i) LIBOR plus a margin of 7.0% or (ii) the greater of (a) the Bank of America prime rate or (b) the Federal Funds rate plus 0.5%, plus a margin of 7%. For purposes of determining the interest rate, in no event shall the base rate or LIBOR be less than 3.0%. In connection with the loan commitments, we will pay a quarterly commitment fee of 1.0% per annum on the average daily amount of undrawn funds. We will also be required to pay a fee equal to 7.0% of the amount of any issued and outstanding letters of credit; provided, with respect to drawable amounts that have been cash collateralized, the letter of credit fee shall be payable at a rate per annum equal to 2.0%.

The proceeds of the loans under the amended credit agreement will be used to refinance our existing indebtedness under the existing credit agreement and to provide ongoing working capital and for other general corporate purposes.

The amended credit agreement contains typical representations and covenants for loans of this type, including restrictions on our ability to pay dividends, make distributions, make acquisitions, incur capital expenditures, incur new liens, or repurchase shares of our common stock. The amended credit agreement also contains financial covenants, including covenants with respect to maximum consolidated adjusted leverage, minimum consolidated fixed charge coverage, minimum tangible net worth, and maximum total capital expenditures. A violation of any of these covenants (including any failure to remain in compliance with any financial covenants contained therein) could result in a default under the amended credit agreement, which would result in termination of all commitments and loans under the amended credit agreement and all other amounts owing under the amended credit agreement and certain other loan agreements becoming immediately due and payable.

After giving effect to the amended credit facility and other transactions completed subsequent to year-end, as of February 27, 2009, we have an available secured line of credit of \$230.0 million (including a \$25.0 million letter of credit sublimit) and separate letter of credit facilities of up to \$48.5 million in the aggregate. As of February 27, 2009, \$195.0 million was drawn on the revolving loan facility and \$71.7 million of letters of credit had been issued under our letter of credit facilities.

Since the amended credit facility matures on August 31, 2010, amounts drawn against the line of credit as of December 31, 2008 have been classified as a long-term liability on the consolidated balance sheet to the extent of the revolving loan commitment availability under the amended credit facility at December 31, 2009, with the \$4.5 million remaining amount classified as a current liability.

Contractual Commitments

The following table presents a summary of our material indebtedness, including the related interest payments, lease and other contractual commitments, as of December 31, 2008.

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	Total	Payments Due by Twelve Months Ending December 31,					
		2009	2010	2011	2012	2013	Thereafter
(dollars in thousands)							
Contractual Obligations:							
Long-term debt obligations(1)(2)(3)	\$ 2,685,190	\$ 109,433	\$ 259,914	\$ 529,471	\$ 923,466	\$ 500,087	\$ 362,819
Capital lease obligations(1)	531,825	46,710	48,792	50,101	49,154	48,418	288,650
Operating lease obligations(4)	2,679,422	261,890	264,482	267,517	268,400	262,032	1,355,101
Refundable entrance fee obligations(5)	206,461	25,808	25,808	25,808	25,808	25,808	77,421
Total contractual obligations	\$ 6,102,898	\$ 443,841	\$ 598,996	\$ 872,897	\$ 1,266,828	\$ 836,345	\$ 2,083,991
Total commercial construction commitments	\$ 66,585	\$ 61,480	\$ 5,105	\$ —	\$ —	\$ —	\$ —

(1) Includes contractual interest for all fixed-rate obligations and assumes interest on variable rate instruments at the December 31, 2008 rate after giving effect to in-place interest rate swaps.

(2) \$131.0 million has been classified beyond its 2009 initial maturity date to 2011 due to our unilateral option to extend the initial maturity date.

(3) Includes the following amounts of scheduled principal payments due on such long-term debt obligations for the respective periods: \$2,234,489 in total; \$13,072 in 2009 (inclusive of the current portion of the line of credit of \$4,453, which was refinanced in February 2009); \$166,742 in 2010 (inclusive of the long term portion of the line of credit of \$155,000, which was refinanced in February 2009); \$452,564 in 2011; \$868,358 in 2012; \$476,254 in 2013; and \$257,499 thereafter.

(4) Reflects future cash payments after giving effect to non-contingent lease escalators and assumes payments on variable rate instruments at the December 31, 2008 rate.

(5) Future refunds of entrance fees are estimated based on historical payment trends. These refund obligations are generally offset by proceeds received from resale of the vacated apartment units. Historically, proceeds from resales of entrance fee units each year generally offset refunds paid and generate excess cash to us.

The foregoing amounts exclude outstanding letters of credit of \$149.7 million as of December 31, 2008. Included in the \$149.7 million of letters of credit outstanding at December 31, 2008 is \$32.2 million of duplicative letters of credit posted with counterparties that were in process of being returned. As of February 27, 2009, these duplicative letters of credit were returned and are no longer outstanding.

Company Indebtedness, Long-term Leases and Hedging Agreements

Indebtedness

We have two principal corporate-level indebtednesses: our \$230.0 million amended credit facility and our unsecured facilities providing for up to \$48.5 million of letters of credit in the aggregate. The remainder of our indebtedness is generally comprised of non-recourse property-level mortgage financings.

As of December 31, 2008, 2007 and 2006, our outstanding property-level secured debt and capital leases were \$2.4 billion, \$2.1 billion and \$1.7 billion, respectively.

During 2008, we incurred \$547.3 million of additional property-level debt primarily related to the financing of acquisitions, the expansion of certain communities and the releveraging of certain assets. Approximately \$158.5 million of the new debt was issued at a variable interest rate (subject to hedge agreements that may effectively cap or convert the debt to a fixed rate) and the remaining \$388.8 million was issued at a fixed interest rate. Refer to the notes to the consolidated financial statements for a detailed discussion of the new debt and related terms.

We have secured our self-insured retention risk under our workers' compensation and general liability and professional liability programs and our lease security deposits with cash and letters of credit aggregating \$10.9 million and \$64.3 million, and \$7.7 million and \$36.4 million as of December 31, 2008 and 2007, respectively.

As of December 31, 2008, we are in compliance with the financial covenants of our outstanding debt, including those covenants measuring facility operating income to gauge debt coverage.

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Long-Term Leases

As of December 31, 2008, we have 358 communities under long-term leases. The leases relating to these communities are generally fixed rate leases with annual escalators that are either fixed or tied to changes in leased property revenue or the consumer price index.

Two portfolio leases have or had a floating-rate debt component built into the lease payments. We acquired one of the portfolios on December 30, 2005. Prior to the acquisition, the lease payment was a pass through of debt service, which includes \$100.8 million of floating rate tax-exempt debt that was credit enhanced by Fannie Mae. Our variable rate exposure under this lease is partially hedged through an interest rate cap. The second lease includes \$96.5 million of variable rate mortgages and/or tax exempt debt that is credit enhanced by Freddie Mac.

For the year ended December 31, 2008, our minimum annual cash lease payments for our capital/financing leases and operating leases were \$44.5 million and \$251.9 million, respectively.

As of December 31, 2008, we are in compliance with the financial covenants of our capital and operating leases, including those covenants measuring facility operating income to gauge lease coverage.

Hedging

In the normal course of business, we use a variety of financial instruments to hedge interest rate risk. We have historically entered into certain interest rate protection and swap agreements to effectively cap or convert floating rate debt to a fixed rate basis. Pursuant to certain of our hedge agreements, we are required to secure our obligation to the counterparty by posting cash or other collateral if the fair value liability exceeds specified thresholds. In periods of significant volatility in the credit markets, the value of these swaps can change significantly and as a result, the amount of collateral we are required to post can change significantly. During 2008, we posted approximately \$39.0 million of cash collateral. We have recently taken a number of steps to reduce this risk. In particular, during 2008, we terminated a number of interest rate swaps with an aggregate notional amount of \$1.1 billion and purchased \$445.2 million in aggregate notional amount of interest rate caps, which do not require the posting of cash collateral. Furthermore, during 2008, we obtained \$37.6 million of swaps that are secured by underlying mortgaged assets and, hence, do not require cash collateralization. As of December 31, 2008, we have \$670.5 million in aggregate notional amount of interest rate caps, \$37.6 million in aggregate notional amount of swaps secured by underlying mortgaged assets, \$314.2 million in aggregate notional amount of swaps that require cash collateralization and \$119.8 million of variable rate debt that is not subject to any cap or swap agreements.

All derivative instruments are recognized as either assets or liabilities in the consolidated balance sheet at fair value.

The following table summarizes our swap instruments at December 31, 2008 (dollars in thousands):

Current notional balance	\$	351,840
Highest possible notional	\$	351,840
Lowest interest rate		3.24%
Highest interest rate		4.47%
Average fixed rate		3.74%
Earliest maturity date		2011
Latest maturity date		2014
Weighted average original maturity		5.0 years
	\$	(20,931)

Estimated liability fair value (included in other liabilities at December 31, 2008)	
Estimated asset fair value (included in other assets at December 31, 2008)	\$ —

The following table summarizes our cap instruments at December 31, 2008 (dollars in thousands):

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Current notional balance	\$	670,521
Highest possible notional	\$	670,521
Lowest interest cap rate		4.96%
Highest interest cap rate		6.50%
Average fixed cap rate		6.02%
Earliest maturity date		2011
Latest maturity date		2012
Weighted average original maturity		4.0 years
Estimated liability fair value (included in other liabilities at December 31, 2008)	\$	—
Estimated asset fair value (included in other assets at December 31, 2008)	\$	350

Impacts of Inflation

Resident fees from the communities we own or lease and management fees from communities we manage for third parties are our primary sources of revenue. These revenues are affected by the amount of monthly resident fee rates and community occupancy rates. The rates charged are highly dependent on local market conditions and the competitive environment in which our communities operate. Substantially all of our retirement center, assisted living, and CCRC residency agreements allow for adjustments in the monthly fee payable thereunder not less frequently than every 12 or 13 months thereby enabling us to seek increases in monthly fees due to inflation, increased levels of care or other factors. Any pricing increase would be subject to market and competitive conditions and could result in a decrease in occupancy in the facilities. We believe, however, that our ability to periodically adjust the monthly fee serves to reduce the adverse effect of inflation. In addition, employee compensation expense is a principal cost element of facility operations and is also dependent upon local market conditions. There can be no assurance that resident fees will increase or that costs will not increase due to inflation or other causes.

At December 31, 2008, approximately \$1.1 billion of our indebtedness, excluding our line of credit, bears interest at floating rates. We have mitigated our exposure to floating rates by using interest rate swaps and interest rate caps under our debt/lease arrangements. Inflation, and its impact on floating interest rates, could affect the amount of interest payments due on our line of credit.

Off-Balance Sheet Arrangements

The equity method of accounting has been applied in the accompanying financial statements with respect to our investment in unconsolidated ventures that are not considered VIEs as we do not possess a controlling financial interest. We do not believe these off-balance sheet arrangements have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Non-GAAP Financial Measures

A non-GAAP financial measure is generally defined as one that purports to measure historical or future financial performance, financial position or cash flows, but excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. In this report, we define and use the non-GAAP financial measures Adjusted EBITDA, Cash From Facility Operations and Facility Operating Income, as set forth below.

Adjusted EBITDA

Definition of Adjusted EBITDA

We define Adjusted EBITDA as follows:

Net income (loss) before:

- provision (benefit) for income taxes;

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- non-operating (income) loss items;
- depreciation and amortization (including non-cash impairment charges);
- straight-line rent expense (income);
- amortization of deferred gain;
- amortization of deferred entrance fees; and
- non-cash compensation expense;

and including:

- entrance fee receipts and refunds.

Management's Use of Adjusted EBITDA

We use Adjusted EBITDA to assess our overall financial and operating performance. We believe this non-GAAP measure, as we have defined it, is helpful in identifying trends in our day-to-day performance because the items excluded have little or no significance on our day-to-day operations. This measure provides an assessment of controllable expenses and affords management the ability to make decisions which are expected to facilitate meeting current financial goals as well as achieve optimal financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

Adjusted EBITDA provides us with a measure of financial performance, independent of items that are beyond the control of management in the short-term, such as depreciation and amortization (including non-cash impairment charges), straight-line rent expense (income), taxation and interest expense associated with our capital structure. This metric measures our financial performance based on operational factors that management can impact in the short-term, namely the cost structure or expenses of the organization. Adjusted EBITDA is one of the metrics used by senior management and the board of directors to review the financial performance of the business on a monthly basis. Adjusted EBITDA is also used by research analysts and investors to evaluate the performance of and value companies in our industry.

Limitations of Adjusted EBITDA

Adjusted EBITDA has limitations as an analytical tool. It should not be viewed in isolation or as a substitute for GAAP measures of earnings. Material limitations in making the adjustments to our earnings to calculate Adjusted EBITDA, and using this non-GAAP financial measure as compared to GAAP net income (loss), include:

- the cash portion of interest expense, income tax (benefit) provision and non-recurring charges related to gain (loss) on sale of communities and extinguishment of debt activities generally represent charges (gains), which may significantly affect our financial results; and
- depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our communities, which affects the services we provide to our residents and may be indicative of future needs for capital expenditures.

An investor or potential investor may find this item important in evaluating our performance, results of operations and financial position. We use non-GAAP financial measures to supplement our GAAP results in order to provide a more complete understanding of the factors and trends affecting our business.

Adjusted EBITDA is not an alternative to net income, income from operations or cash flows provided by or used in operations as calculated and presented in accordance with GAAP. You should not rely on Adjusted EBITDA as a substitute for any such GAAP financial measure. We strongly urge you to review the reconciliation of Adjusted EBITDA to GAAP net income (loss), along with our consolidated financial statements included herein. We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because Adjusted EBITDA is not a measure of financial performance under GAAP and is susceptible to varying

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calculations, the Adjusted EBITDA measure, as presented in this report, may differ from and may not be comparable to similarly titled measures used by other companies.

The table below shows the reconciliation of our net loss to Adjusted EBITDA for the years ended December 31, 2008, 2007 and 2006 (dollars in thousands):

	Years Ended December 31, (1)		
	2008	2007(2)(3)	2006(2)
Net loss	\$ (373,241)	\$ (161,979)	\$ (108,087)
Benefit for income taxes	(86,731)	(101,260)	(38,491)
Other non-operating income	(1,708)	(402)	—
Minority interest	—	(393)	671
Equity in loss of unconsolidated ventures	861	3,386	3,705
Loss on extinguishment of debt	3,052	2,683	1,526
Interest expense			
Debt	119,853	114,518	74,133
Capitalized lease obligation	27,536	29,473	23,561
Amortization of deferred financing costs	9,707	7,064	5,061
Change in fair value of derivatives and amortization	68,146	73,222	38
Interest income	(7,618)	(7,519)	(6,810)
Loss from operations	(240,143)	(41,207)	(44,693)
Depreciation and amortization	276,202	299,925	188,129
Goodwill and asset impairment	220,026	—	—
Straight-line lease expense	20,585	25,439	24,699
Amortization of deferred gain	(4,342)	(4,342)	(4,345)
Amortization of entrance fees	(22,025)	(19,241)	(8,149)
Non-cash compensation expense	28,937	20,113	26,612
Entrance fee receipts(4)	42,472	45,249	27,556
Entrance fee disbursements	(19,150)	(19,557)	(9,188)
Adjusted EBITDA	\$ 302,562	\$ 306,379	\$ 200,621

- (1) The calculation of Adjusted EBITDA includes merger, integration, and hurricane and named tropical storms expense as well as other non-recurring and acquisition transition costs totaling \$24.3 million, \$19.0 million and \$16.8 million for the years ended December 31, 2008, 2007 and 2006, respectively. The 2008 amount includes the effect of the \$8.0 million reserve established for certain litigation (Note 21).
- (2) Adjusted EBITDA for the years ended December 31, 2007 and 2006 includes a non-cash benefit of \$0.3 million and \$4.1 million, respectively, related to a reversal of an accrual established in connection with Alterra's emergence from bankruptcy in December 2003.
- (3) Adjusted EBITDA for the year ended December 31, 2007 includes \$7.0 million of charges to facility operating expenses in the quarter ended December 31, 2007, which relates to our desire to conform our policies across all of our platforms including \$5.9 million related to estimated uncollectible accounts and \$1.1 million of accounting conformity adjustments pertaining to inventory and certain accrual policies.
- (4) Includes the receipt of refundable and nonrefundable entrance fees.

Cash From Facility Operations

Definition of Cash From Facility Operations

We define Cash From Facility Operations (CFFO) as follows:

Net cash provided by (used in) operating activities adjusted for:

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- changes in operating assets and liabilities;
- deferred interest and fees added to principal;
- refundable entrance fees received;
- entrance fee refunds disbursed;
- lease financing debt amortization with fair market value or no purchase options;
 - other; and
 - recurring capital expenditures.

Recurring capital expenditures include expenditures capitalized in accordance with GAAP that are funded from CFFO. Amounts excluded from recurring capital expenditures consist primarily of unusual or non-recurring capital items (including integration capital expenditures), community purchases and/or major projects or renovations that are funded using financing proceeds and/or proceeds from the sale of communities that are held for sale. Beginning in 2008, our calculation of CFFO was modified to subtract principal amortization related to capital leases that contain fair market value or no purchase options.

Management's Use of Cash From Facility Operations

We use CFFO to assess our overall liquidity. This measure provides an assessment of controllable expenses and affords management the ability to make decisions which are expected to facilitate meeting current financial and liquidity goals as well as to achieve optimal financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

This metric measures our liquidity based on operational factors that management can impact in the short-term, namely the cost structure or expenses of the organization. CFFO is one of the metrics used by our senior management and board of directors (i) to review our ability to service our outstanding indebtedness (including our credit facilities and long-term leases), (ii) our ability to pay dividends to stockholders, (iii) our ability to make regular recurring capital expenditures to maintain and improve our communities on a period-to-period basis, (iv) for planning purposes, including preparation of our annual budget and (v) in setting various covenants in our credit agreements. These agreements generally require us to escrow or spend a minimum of between \$250 and \$450 per unit/bed per year. Historically, we have spent in excess of these per unit/bed amounts; however, there is no assurance that we will have funds available to escrow or spend these per unit/bed amounts in the future. If we do not escrow or spend the required minimum annual amounts, we would be in default of the applicable debt or lease agreement which could trigger cross default provisions in our outstanding indebtedness and lease arrangements.

Limitations of Cash From Facility Operations

CFFO has limitations as an analytical tool. It should not be viewed in isolation or as a substitute for GAAP measures of cash flow from operations. CFFO does not represent cash available for dividends or discretionary expenditures, since we may have mandatory debt service requirements or other non-discretionary expenditures not reflected in the measure. Material limitations in making the adjustment to our cash flow from operations to calculate CFFO, and using this non-GAAP financial measure as compared to GAAP operating cash flows, include:

- the cash portion of interest expense, income tax (benefit) provision and non-recurring charges related to gain (loss) on sale of communities and extinguishment of debt activities generally represent charges (gains), which may significantly affect our financial results; and
- depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our communities, which affects the services we provide to our residents and may be indicative of future needs for capital expenditures.

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We believe CFFO is useful to investors because it assists their ability to meaningfully evaluate (1) our ability to service our outstanding indebtedness, including our credit facilities and capital and financing leases, (2) our ability to pay dividends to stockholders and (3) our ability to make regular recurring capital expenditures to maintain and improve our communities.

CFFO is not an alternative to cash flows provided by or used in operations as calculated and presented in accordance with GAAP. You should not rely on CFFO as a substitute for any such GAAP financial measure. We strongly urge you to review the reconciliation of CFFO to GAAP net cash provided by (used in) operating activities, along with our consolidated financial statements included herein. We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because CFFO is not a measure of financial performance under GAAP and is susceptible to varying calculations, the CFFO measure, as presented in this report, may differ from and may not be comparable to similarly titled measures used by other companies.

The table below shows the reconciliation of net cash provided by operating activities to CFFO for the years ended December 31, 2008, 2007 and 2006 (dollars in thousands):

	Years Ended December 31,(1)		
	2008	2007(2)(3)	2006(2)
Net cash provided by operating activities	\$ 136,767	\$ 199,662	\$ 85,912
Changes in operating assets and liabilities	25,865	(36,571)	17,936
Refundable entrance fees received (4)	19,871	25,919	14,760
Entrance fee refunds disbursed	(19,150)	(19,557)	(9,188)
Recurring capital expenditures	(27,312)	(25,048)	(23,518)
Lease financing debt amortization with fair market value or no purchase options	(6,691)	(5,594)	(2,213)
Reimbursement of operating expenses and other	794	4,430	5,000
Cash From Facility Operations	\$ 130,144	\$ 143,241	\$ 88,689

- (1) The calculation of CFFO includes merger, integration, and hurricane and named tropical storms expense as well as other non-recurring and acquisition transition costs totaling \$24.3 million, \$19.0 million and \$16.8 million for the years ended December 31, 2008, 2007 and 2006, respectively. The 2008 amount includes the effect of the \$8.0 million reserve established for certain litigation (Note 21).
- (2) The December 31, 2007 and 2006 amounts have been reclassified to conform to the modified definition of CFFO used during the year ended December 31, 2008.
- (3) CFFO for the year ended December 31, 2007 includes \$7.0 million of charges to facility operating expenses in the quarter ended December 31, 2007, which relates to our desire to conform our policies across all of our platforms including \$5.9 million of estimated uncollectible accounts and \$1.1 million of accounting conformity adjustments pertaining to inventory and certain accrual policies.
- (4) Total entrance fee receipts for the year ended December 31, 2008, 2007 and 2006 were \$42.5 million, \$45.2 million and \$27.6 million, respectively, including \$22.6 million, \$19.3 million and \$12.8 million, respectively, of nonrefundable entrance fee receipts included in net cash provided by operating activities.

Facility Operating Income

Definition of Facility Operating Income

We define Facility Operating Income as follows:

Net income (loss) before:

- provision (benefit) for income taxes;
- non-operating (income) loss items;
- depreciation and amortization (including non-cash impairment charges);

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- facility lease expense;
- general and administrative expense, including non-cash stock compensation expense;
 - amortization of deferred entrance fee revenue; and
 - management fees.

Management's Use of Facility Operating Income

We use Facility Operating Income to assess our facility operating performance. We believe this non-GAAP measure, as we have defined it, is helpful in identifying trends in our day-to-day facility performance because the items excluded have little or no significance on our day-to-day facility operations. This measure provides an assessment of revenue generation and expense management and affords management the ability to make decisions which are expected to facilitate meeting current financial goals as well as to achieve optimal facility financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

Facility Operating Income provides us with a measure of facility financial performance, independent of items that are beyond the control of management in the short-term, such as depreciation and amortization, lease expense, taxation and interest expense associated with our capital structure. This metric measures our facility financial performance based on operational factors that management can impact in the short-term, namely the cost structure or expenses of the organization. Facility Operating Income is one of the metrics used by our senior management and board of directors to review the financial performance of the business on a monthly basis. Facility Operating Income is also used by research analysts and investors to evaluate the performance of and value companies in our industry by investors, lenders and lessors. In addition, Facility Operating Income is a common measure used in the industry to value the acquisition or sales price of communities and is used as a measure of the returns expected to be generated by a facility.

A number of our debt and lease agreements contain covenants measuring Facility Operating Income to gauge debt or lease coverages. The debt or lease coverage covenants are generally calculated as facility net operating income (defined as total operating revenue less operating expenses, all as determined on an accrual basis in accordance with GAAP). For purposes of the coverage calculation, the lender or lessor will further require a pro forma adjustment to facility operating income to include a management fee (generally 4% to 5% of operating revenue) and an annual capital reserve (generally \$250 to \$450 per unit/bed). An investor or potential investor may find this item important in evaluating our performance, results of operations and financial position, particularly on a facility-by-facility basis.

Limitations of Facility Operating Income

Facility Operating Income has limitations as an analytical tool. It should not be viewed in isolation or as a substitute for GAAP measures of earnings. Material limitations in making the adjustments to our earnings to calculate Facility Operating Income, and using this non-GAAP financial measure as compared to GAAP net income (loss), include:

- interest expense, income tax (benefit) provision and non-recurring charges related to gain (loss) on sale of communities and extinguishment of debt activities generally represent charges (gains), which may significantly affect our financial results; and
- depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our communities, which affects the services we provide to our residents and may be

indicative of future needs for capital expenditures.

An investor or potential investor may find this item important in evaluating our performance, results of operations and financial position on a facility-by-facility basis. We use non-GAAP financial measures to supplement our GAAP results in order to provide a more complete understanding of the factors and trends affecting our business. Facility Operating Income is not an alternative to net income, income from operations or cash flows provided by or used in operations as calculated and presented in accordance with GAAP. You should not rely on Facility

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Operating Income as a substitute for any such GAAP financial measure. We strongly urge you to review the reconciliation of Facility Operating Income to GAAP net income (loss), along with our consolidated financial statements included herein. We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because Facility Operating Income is not a measure of financial performance under GAAP and is susceptible to varying calculations, the Facility Operating Income measure, as presented in this report, may differ from and may not be comparable to similarly titled measures used by other companies.

The table below shows the reconciliation of net loss to Facility Operating Income for the years ended December 31, 2008, 2007 and 2006 (dollars in thousands):

	Years Ended December 31,		
	2008	2007(1)(2)	2006(1)
Net loss	\$ (373,241)	\$ (161,979)	\$ (108,087)
Loss on discontinued operations	—	—	—
Benefit for income taxes	(86,731)	(101,260)	(38,491)
Other non-operating income	(1,708)	(402)	—
Minority interest	—	(393)	671
Equity in loss of unconsolidated ventures	861	3,386	3,705
Loss on extinguishment of debt	3,052	2,683	1,526
Interest expense			
Debt	119,853	114,518	74,133
Capitalized lease obligation	27,536	29,473	23,561
Amortization of deferred financing costs	9,707	7,064	5,061
Change in fair value of derivatives and amortization	68,146	73,222	38
Interest income	(7,618)	(7,519)	(6,810)
Loss from operations	(240,143)	(41,207)	(44,693)
Depreciation and amortization	276,202	299,925	188,129
Goodwill and asset impairment	220,026	—	—
Facility lease expense	269,469	271,628	228,779
General and administrative (including non-cash stock compensation expense)	140,919	138,013	117,897
Amortization of entrance fees	(22,025)	(19,241)	(8,149)
Management fees	(6,994)	(6,789)	(5,617)
Facility Operating Income	\$ 637,454	\$ 642,329	\$ 476,346

(1) Facility Operating Income for the years ended December 31, 2007 and 2006 includes a non-cash benefit of \$0.3 million and \$4.1 million, respectively, related to a reversal of an accrual established in connection with Alterra's emergence from bankruptcy in December 2003.

(2) Facility operating income for the year ended December 31, 2007 includes \$7.0 million of charges to facility operating expenses in the quarter ended December 31, 2007, which relates to our desire to conform our policies across all of our platforms including \$5.9 million of estimated uncollectible accounts and \$1.1 million of accounting conformity adjustments pertaining to inventory and certain accrual policies.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

We are subject to market risks from changes in interest rates charged on our credit facilities, other floating-rate indebtedness and lease payments subject to floating rates. The impact on earnings and the value of our long-term debt and lease payments are subject to change as a result of movements in market rates and prices. As of December 31, 2008, excluding our line of credit and capital and financing lease obligations, we had approximately \$932.9 million of fixed rate debt, of which \$930.1 is classified as long-term, \$1.1 billion of variable rate debt, of which \$1.0 billion is classified as long-term, and \$318.4 million of capital and financing lease obligations. As of December 31, 2008, our total fixed-rate debt and variable-rate debt outstanding had weighted-average interest rates of 4.91%.

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We enter into certain interest rate swap agreements with major financial institutions to manage our risk on variable rate debt. Additionally, during 2008, we entered into certain cap agreements to effectively manage our risk above certain interest rates. As of December 31, 2008, \$1.3 billion, or 61.9%, of our debt, excluding our line of credit and capital and financing lease obligations, either has fixed rates or variable rates that are subject to swap agreements. As of December 31, 2008, \$670.5 million, or 32.3%, of our debt, excluding our line of credit and capital and financing lease obligations, is subject to cap agreements. The remaining \$119.8 million, or 5.8%, of our debt is variable rate debt, not subject to any cap or swap agreements. A change in interest rates would have impacted our interest rate expense related to all outstanding variable rate debt, excluding our line of credit and capital and financing lease obligations, as follows: a one, five and ten percent change in interest rates would have an impact of \$7.8 million, \$38.8 million and \$48.9 million, respectively.

As noted above, we have entered into certain interest rate protection and swap agreements to effectively cap or convert floating rate debt to a fixed rate basis, as well as to hedge anticipated future financing transactions. Pursuant to certain of our hedge agreements, we are required to secure our obligation to the counterparty by posting cash or other collateral if the fair value liability exceeds a specified threshold. A change in the interest rates of 25 basis points would impact our cash or other collateral by \$1.6 million.

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Item 8. Financial Statements and Supplementary Data.

BROOKDALE SENIOR LIVING INC.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Brookdale Senior Living Inc.

We have audited the accompanying consolidated balance sheets of Brookdale Senior Living Inc. and subsidiaries (the “Company”) as of December 31, 2008 and 2007, and the related consolidated statements of operations, equity and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule listed in the accompanying index to the financial statements. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 27, 2009

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Brookdale Senior Living Inc.

We have audited Brookdale Senior Living Inc.'s (the "Company") internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Assessment of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2008 and 2007 and the related consolidated statements of operations, equity, and cash flows for each of the three years in the period ended December 31, 2008, and our report dated February 27, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 27, 2009

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BROOKDALE SENIOR LIVING INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except stock amounts)

	December 31,	
	2008	2007
Assets		
Current assets		
Cash and cash equivalents	\$ 53,973	\$ 100,904
Cash and escrow deposits – restricted	86,723	76,962
Accounts receivable, net	91,646	66,807
Deferred tax asset	14,677	13,040
Prepaid expenses and other current assets, net	33,766	34,122
Total current assets	280,785	291,835
Property, plant and equipment and leasehold intangibles, net	3,694,784	3,760,453
Cash and escrow deposits – restricted	29,988	17,989
Investment in unconsolidated ventures		