

Brookdale Senior Living Inc.  
Form 10-K  
February 28, 2012

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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, 2011

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 400  
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 Registered
Common Stock, \$0.01 Par Value Per Share	New York Stock Exchange

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SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:  
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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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, 2011, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$2.01 billion. The market value calculation was determined using a per share price of \$24.25, 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, 2012, 121,132,967 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 2012 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on 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 the consummation of the restructuring of the management agreements with Chartwell Seniors Housing Real Estate Investment Trust; statements relating to our operational initiatives and our expectations regarding their effect on our results; our expectations regarding occupancy, revenue, cash flow, expenses, capital expenditures, Program Max opportunities, cost savings, the demand for senior housing, expansion and development activity, acquisition opportunities, asset dispositions, our share repurchase program and taxes; our belief regarding the value of our common stock and our growth prospects; our ability to secure financing or repay, replace or extend existing debt at or prior to maturity; 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 plans to deleverage; our expectations regarding financings and refinancings of assets (including the timing thereof) and their effect on our results; our expectations regarding changes in government reimbursement programs and their effect on our results; 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, home health and hospice); our plans to expand, redevelop and reposition existing communities; our plans to acquire additional communities, asset portfolios, operating companies and home health agencies; the expected project costs for our expansion, redevelopment and repositioning program; our expected levels of expenditures and reimbursements (and the timing 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 that we may not be able to satisfy the conditions and successfully complete the Chartwell management agreement restructuring; the risk that we may not be able to successfully integrate the new Horizon Bay communities into our operations; our determination from time to time to purchase any shares under the repurchase program; our ability to fund any repurchases; the risk associated with the current global economic crisis and its impact upon capital markets and liquidity; our inability to extend (or refinance) debt (including our credit and letter of credit facilities) as 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; changes in governmental reimbursement programs; our ability to effectively manage our growth; our ability to maintain consistent quality control; delays in obtaining regulatory approvals; the risk that we may not be able to expand and redevelop our communities in accordance with our plans; our ability to complete acquisitions and integrate them 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; early terminations or non-renewal of management agreements; 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

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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.

## PART I

## Item 1. Business.

## Overview

As of December 31, 2011, we are the largest operator of senior living communities in the United States based on total capacity, with 647 communities in 36 states and the ability to serve approximately 67,100 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, 2011, we operated in four business segments: retirement centers, assisted living, continuing care retirement communities (“CCRCs”) and management services.

As of December 31, 2011, we operated 76 retirement center communities with 14,563 units, 434 assisted living communities with 21,673 units, 40 CCRCs with 12,569 units and 97 communities with 18,302 units where we provide management services for third parties or joint ventures in which we have an ownership interest. The majority of our units are located in campus settings or communities containing multiple services, including CCRCs. For the year ended December 31, 2011, the weighted average occupancy rate for our owned/leased communities was 87.3%. We generate approximately 79.5% of our revenues from private pay customers. For the year ended December 31, 2011, 40.8% of our revenues were generated from owned communities, 52.4% from leased communities and 6.8% from management fees from communities we operate on behalf of third parties or joint ventures.

The table below presents a summary of our operating results and certain other financial metrics for each of the years ended December 31, 2011, 2010 and 2009 (dollars in millions):

	For the Years Ended December 31,		
	2011	2010	2009
Total revenues	\$ 2,457.9	\$ 2,280.5	\$ 2,100.3
Net loss(1)	\$ (68.2 )	\$ (48.9 )	\$ (66.3 )
Adjusted EBITDA(2)	\$ 402.7	\$ 408.5	\$ 348.6
Cash From Facility Operations(3)	\$ 239.9	\$ 240.7	\$ 196.8
Facility Operating Income(2)	\$ 757.8	\$ 744.3	\$ 690.1

(1) Net loss for 2011, 2010 and 2009 include non-cash impairment charges of \$16.9 million, \$13.1 million and \$10.1 million, respectively.

(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.

Our operating results for the year ended December 31, 2011 were favorably impacted by an increase in our total revenues, primarily driven by an increase in average monthly revenue per unit, including an increase in our ancillary services revenue, as well as the inclusion of revenue from recent acquisitions. Although we have made significant progress in many areas of our business, the difficult operating environment has continued to result in occupancy rates that are lower than historical levels and diminished growth in the rates we charge our residents.

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During 2011, we continued our efforts to strengthen our financial position. For example, on January 31, 2011, we entered into an amended and restated credit agreement with General Electric Capital Corporation, as administrative agent and lender, and the other lenders from time to time parties thereto. The amended credit agreement amended and restated our previous credit agreement. The amended credit agreement increased the commitment under the credit facility to \$200.0 million and extended the maturity date to January 31, 2016. Effective February 23, 2011, the commitment under the amended credit agreement was further increased to \$230.0 million. In addition, during the second quarter, we completed a registered offering of \$316.3 million aggregate principal amount of 2.75% convertible senior notes due 2018. The net proceeds from the offering were used to repay a portion of our outstanding mortgage debt. We ended the year with \$30.8 million of unrestricted cash and cash equivalents on our consolidated balance sheet and \$194.2 million of availability on our revolving credit facility (of which \$65.0 million had been drawn as of December 31, 2011).

On September 1, 2011, we completed the acquisition of 100% of the equity interests in Horizon Bay Realty, L.L.C. (“Horizon Bay”). As a result of the transaction, we added to our portfolio 91 communities with over 16,200 units in 19 states.

In connection with the acquisition, we restructured Horizon Bay’s existing relationship with HCP, Inc. (“HCP”) relating to 33 communities that Horizon Bay leased from HCP. First, we formed a joint venture with HCP to own and operate 21 of the communities utilizing a REIT Investment Diversification and Empowerment Act of 2007 (“RIDEA”) structure. We acquired a 10% interest in the RIDEA joint venture. We also manage the communities under a ten-year management agreement with four five-year renewal options and will retain all ancillary services operations. The 21-community portfolio has a total of 5,000 units (approximately 4,206 independent living, 721 assisted living, and 73 Alzheimer’s/dementia care units) and is primarily located in Florida, Texas, Illinois and Rhode Island.

Second, we entered into long term, triple net leases with HCP relating to 12 communities with a total of 1,546 units (approximately 578 independent living, 595 assisted living, 217 Alzheimer’s/dementia care and 156 skilled nursing units). The leased portfolio is primarily located in Texas and Rhode Island.

We also provide management services to the remaining 58 Horizon Bay communities, which contain approximately 9,667 units, consisting of 5,527 independent living units, 3,174 assisted living units, 477 Alzheimer’s/dementia care units and 489 skilled nursing beds in 15 states. The management contracts are generally long-term agreements with base management fees and potential incentive fees. In conjunction with the acquisition, we entered into an agreement to restructure the management agreements with Chartwell Seniors Housing Real Estate Investment Trust (“Chartwell”) relating to 45 of these communities (with a total of 6,359 units). As part of the restructuring of the management agreements, Chartwell granted us an option through 2013 to acquire a 20% interest in Chartwell’s U.S. real estate assets that we manage. We also have a right of first offer to acquire any of Chartwell’s assets that we manage.

Certain elements of the Chartwell management arrangement restructuring are subject to lender and other third party approvals. Until these approvals are received, we will operate Chartwell’s properties under the existing management contracts.

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. Our strategy is to be the leading provider of wellness and healthcare solutions within the senior living

industry. 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 maintaining expense control, at our existing

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communities, continuing the expansion and maturation of our ancillary services programs, expanding, redeveloping and repositioning our existing communities, and acquiring additional operating companies and 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, home health and hospice services). 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 expanding the scope of services provided at the communities currently served and the continuing rollout of ancillary services programs to communities not currently serviced. In addition, we plan to grow our revenues from ancillary services through the maturation of existing clinics. 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 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 and to seniors living outside of our communities. 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 have also begun offering hospice services in certain locations. 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 the scope of services at communities currently served and continuing the rollout of ancillary services programs to additional communities, which we believe will increase our revenue per unit in the future. As of December 31, 2011, we offered therapy services to approximately 36,200 of our units and home health services to approximately 29,000 of our units.
- Growth through the expansion, redevelopment and repositioning of existing communities. Through our Program Max initiative, we intend to grow our revenues and cash flows through the expansion, redevelopment and repositioning 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. Through Program Max, we may also reposition certain communities to meet the evolving needs of our customers. This may include converting space from one level of care to another, reconfiguration of existing units, or the addition of services that are not currently present.

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- Growth through the acquisition and consolidation of asset portfolios and other senior living companies. As opportunities arise, we plan to continue to take advantage of the fragmented continuing care, independent living and assisted living sectors by selectively purchasing existing operating companies, asset portfolios, home health agencies and senior living communities. We may also seek to acquire 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 economic environment in general. In spite of these factors, over the past year, industry occupancy has continued its slow recovery that has been underway since the beginning of 2010 according to the National Investment Center for the Seniors Housing & Care Industry ("NIC"). According to NIC, occupancy has increased 90 basis points to 88.0% in the independent living sector, has increased 30 basis points to 88.6% in the assisted living sector and has increased 10 basis points to 88.9% in the CCRC sector in the twelve months ended December 31, 2011. Industry occupancy rates had been declining after reaching a cyclic high in early 2007 of 92.3% according to NIC. Over the past year, occupancy has been rising modestly, as the pace of absorption has been outpacing inventory growth. New senior housing construction starts have slowed dramatically since late 2008. Due to the continued impact of the economic recession, securing financing for new projects has been very difficult. For the foreseeable future, there will likely be very limited amounts of new construction in senior living.

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 75 and older. According to U.S. Census data, the group is expected to grow by 1.2 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, a 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 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 sectors, 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, 2012. If these exceptions are modified or not extended beyond that date, our revenues and net operating income relating to our outpatient therapy services could be materially adversely impacted. In addition, 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. For example, the Centers for Medicare & Medicaid Services ("CMS") recently adopted a final rule reducing Medicare skilled nursing facility Prospective Payment System payments for the federal government's 2012 fiscal year. In addition, payments for our outpatient therapy services

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are tied to Medicare's physician payment fee schedule. By statute, the physician fee schedule is subject to annual automatic adjustment by a sustainable growth rate ("SGR") formula that has resulted in reductions in reimbursement rates every year since 2002. However, in each case, Congress has acted to suspend or postpone the effectiveness of these automatic reimbursement reductions. If Congress does not extend this relief, as it has done since 2002, or permanently modify the SGR formula by January 1, 2013, payment levels for outpatient therapy services under the physician fee schedule will be reduced at that point by approximately 27%. We cannot predict what action, if any, Congress will take on the physician fee schedule or what future rule changes CMS will implement. This uncertainty is only exacerbated by the ongoing deficit reduction discussions in Washington. As part of its attempts to mitigate the impact of the reduction on physicians, it is possible that Congress may elect to reduce reimbursement rates for other Medicare providers. Changes in the reimbursement policies of the Medicare program 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. 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. On September 1, 2011, we completed the acquisition of Horizon Bay, the then-ninth largest operator of senior living communities in the United States.

## 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; (iii) CCRCs and (iv) management services.

**Retirement Centers.** Our retirement center communities are primarily designed for middle to upper income seniors generally age 75 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 76.8% 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 192 units 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 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 activities of daily living, or ADLs. The levels of care provided to residents vary from community to community depending, among other things, upon the licensing requirements and healthcare regulations 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

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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.

The communities in our Retirement Centers segment represent approximately 21.7% 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 50 beds and smaller, freestanding single story communities with less than 50 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 86 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 19 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.

The communities in our Assisted Living segment (including our memory care communities) represent approximately 32.3% 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 independent living, assisted living and skilled nursing available on one campus, and some also include memory care/Alzheimer’s service areas.

Eleven of our CCRCs that we own or lease are entrance fee communities, in which residents in the independent living 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 some agreements, upon the resale of a

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comparable unit or 12 months after the resident vacates the unit. In addition, some 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.

The communities in our CCRCs segment represent approximately 18.7% of our total senior living capacity. The independent living units at our entrance fee communities (those units on which entry fees are paid) represent 4.6% 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), entrance fee communities represent 9.7% of our total senior living capacity.

**Management Services.** We operate certain of our communities pursuant to management agreements. In some of these cases, the controlling financial interest in the community is held by third parties and, in other cases, the community is owned in a joint venture structure in which we have an ownership interest. Under the management agreements for these communities, we receive management fees as well as reimbursed expenses, which represent the reimbursement of certain expenses we incur on behalf of the owners.

The communities in our Management Services segment represent 27.3% of our total senior living capacity. As of December 31, 2011, we managed a total of 97 communities with a total of 18,302 units on behalf of third parties or joint ventures in which we have an ownership interest. There are a total of 63 retirement centers, 22 assisted living communities and 12 CCRC communities (of which six are entrance fee communities) in our Management Services segment.

## 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, 2011, we operate a nationwide base of 647 purpose-built communities in 36 states, including 108 communities in nine of the ten most populous standard metropolitan statistical areas.
- **Ability to provide a broad spectrum of care.** Given our diverse mix of retirement centers, 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 and the only company that does so at scale on a national basis. 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.

- 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

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home health agencies located in our senior living communities to provide needed services to our residents is a distinct 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 and to seniors outside of our communities.

## Segments

As of December 31, 2011, 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.

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 24 to our consolidated financial statements included in this Annual Report on Form 10-K.

## 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 average 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 internet inquiries, 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 implemented several 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 center and assisted living sectors of the senior living industry are not substantial, except in the skilled nursing area. 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 which operate senior living communities are Sunrise Senior Living, Inc., Emeritus Corporation and Capital Senior Living Corporation and our major private competitors include Life Care Services, LLC and Atria Senior Living Group, as well as a large number of not-for-profit entities. Partially as a result of tax law changes enacted through RIDEA, we now compete more directly with the various publicly-traded healthcare REITs for the acquisition of senior housing properties. The largest three of these publicly-traded healthcare REITs measured on equity market capitalization include HCP, Inc., Ventas, Inc. and Health Care REIT, Inc.

### Customers

Our target retirement center residents are senior citizens age 75 and older who desire or need a more supportive living environment. The average retirement center resident resides in a retirement center community for approximately 31 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 approximately 19 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 independent living unit and may later move into an assisted living or skilled nursing area 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, 2011, we had approximately 29,200 full-time employees and approximately 17,200 part-time employees, of which 416 work in our Nashville headquarters office, 437 work in our Milwaukee office, 59 work in our Chicago office, 42 work in our Tampa office, and 173 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;

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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.

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

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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 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.

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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 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-contaminated 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

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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. 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 (including legislative or regulatory efforts designed to address climate change, such as the proposed "cap and trade" legislation) 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 these 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](http://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](http://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 400, Brentwood, Tennessee 37027.

Item 1A. Risk Factors.

### Risks Related to Our Business

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.

In recent years, the United States stock and credit markets have experienced significant price volatility, dislocations and liquidity disruptions, which caused market prices of many stocks to fluctuate substantially and the spreads on prospective debt financings to widen considerably. These circumstances materially impacted liquidity in the financial markets, making terms for certain financings less attractive, and in some cases 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.

As of December 31, 2011, we had three principal corporate-level debt obligations: our \$230.0 million revolving credit facility, our \$316.3 million convertible senior notes due 2018 and separate secured and unsecured letter of credit facilities providing for up to \$85.7 million of letters of credit in the aggregate. If we are unable to extend (or refinance, as applicable) any of our debt or credit or letter of credit facilities prior to their scheduled maturity

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dates, our liquidity and financial condition could be adversely impacted. In addition, even if we are able to extend or refinance our other maturing debt or credit 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.

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, 2012. If these exceptions are modified or not extended beyond that date, our revenues and net operating income relating to our outpatient therapy services could be materially adversely impacted.

In addition, 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. For example, the Centers for Medicare & Medicaid Services (“CMS”) recently adopted a final rule reducing Medicare skilled nursing facility Prospective Payment System payments for the federal government’s 2012 fiscal year. In addition, payments for our outpatient therapy services are tied to Medicare’s physician payment fee schedule. By statute, the physician fee schedule is subject to annual automatic adjustment by a sustainable growth rate (“SGR”) formula that has resulted in reductions in reimbursement rates every year since 2002. However, in each case, Congress has acted to suspend or postpone the effectiveness of these automatic reimbursement reductions. If Congress does not extend this relief, as it has done since 2002, or permanently modify the SGR formula by January 1, 2013, payment levels for outpatient therapy services under the physician fee schedule will be reduced at that point by approximately 27%. We cannot predict what action, if any, Congress will take on the physician fee schedule or what future rule changes CMS will implement. This uncertainty is only exacerbated by the ongoing deficit reduction discussions in Washington. As part of its attempts to mitigate the impact of the reduction on physicians, it is possible that Congress may elect to reduce reimbursement rates for other Medicare providers. Changes in the reimbursement policies of the Medicare program could have an adverse effect on our results of operations and cash flow.

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 and unemployment among resident family members) 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, higher levels of unemployment among resident family members, 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

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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 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, 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:

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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, repositionings, new developments, acquisitions, general corporate and other purposes; and

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- 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. These 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. Any contemplated financing, refinancing or sale of assets might not be available on economically favorable terms to us. In addition, certain of our debt agreements contain extension options. If we are not able to satisfy the conditions precedent to exercising these extension options our liquidity and financial condition could be negatively impacted.

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 credit facilities, mortgage loans 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 and management agreements also contain radius restrictions, which limit our ability to own, develop or acquire new communities within a specified distance from certain existing communities

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covered by such agreements. 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.

In addition, our leases generally provide for renewal or extension options and, in certain cases, purchase options. These options generally are based upon prescribed formulas but, in certain cases, may be at fair market value. We expect to renew, extend or exercise purchase options with respect to our leases in the normal course of business; however, there can be no assurance that these rights will be exercised in the future or that we will be able to satisfy the conditions precedent to exercising any such renewal, extension or purchase options. Furthermore, the terms of any such options that are based on fair market value are inherently uncertain and could be unacceptable or unfavorable to us depending on the circumstances at the time of exercise. If we are not able to renew or extend our existing leases, or purchase the communities subject to such leases, at or prior to the end of the existing lease terms, or if the terms of such options are unfavorable or unacceptable to us, our business, financial condition and results of operation could be adversely affected.

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 certain of 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 also are exposed to the risk that our counterparties to our hedge agreements will default on their obligations. We manage our exposure to this risk by limiting the counterparties to major international banks and financial institutions meeting established guidelines. However, any default by such counterparties may have an adverse effect on us.

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, home health and hospice) 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 or redevelop 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, reposition or redevelop a number of our existing senior living communities over the next several years. These projects are in various stages of development and are subject to a number of factors over which we have little or no control. These 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, repositioning 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, repositioning 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 identifying potential acquisition candidates, completing acquisition transactions and integrating acquired communities into our existing operations may result in unforeseen operating difficulties, divert managerial attention or require significant financial or other 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 will not increase. Finally, when we are able to locate communities and enter into definitive agreements to acquire or lease them, we cannot

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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. Partially as a result of recent tax law changes enacted through RIDEA, we now compete more directly with the various publicly-traded healthcare REITs for the acquisition of senior housing properties.

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, redevelopment and repositioning 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.

In addition, we are heavily dependent on mortgage financing provided by Federal National Mortgage Association (“Fannie Mae”) and Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively, the “Agency Lenders”). The Agency Lenders are currently operating under a conservatorship begun in 2008, conducting business under the direction of the Federal Housing Finance Agency. Reform efforts related to the Agency Lenders may make such financing sources less available or unavailable in the future and may cause us to seek alternative sources of potentially less attractive financing. There can be no assurance that such alternative sources will be available.

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, 2011, we owned or leased 11 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

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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 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.



Early termination or non-renewal of our management agreements could cause a loss in revenues.

We operate certain of our communities pursuant to management agreements. In some of these cases, the controlling financial interest in the community is held by third parties and, in other cases, the community is owned in a joint venture structure in which we have an ownership interest. At December 31, 2011, approximately 15.0% of our communities were managed for third parties or unconsolidated ventures. We obtained a significant portion of our management agreements as a result of our acquisition of Horizon Bay in

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2011. The majority of our management agreements are long-term agreements. In most cases, either party to the agreements may terminate upon the occurrence of an event of default caused by the other party. In addition, in some cases, subject to our rights, if any, to cure deficiencies, community owners may terminate us as manager if any licenses or certificates necessary for operation are revoked, if we do not satisfy certain designated performance thresholds or if the community is sold to an unrelated third party (in which case we may be entitled to receive a contractual termination fee). Also, in some instances, a community owner may terminate the management agreement relating to a particular community if we are in default under other management agreements relating to other communities owned by the same owner or its affiliates. Certain of our management agreements, both with joint ventures and with entities owned by third parties, provide that an event of default under the debt instruments applicable to the ventures or the entities owned by third parties that is caused by us may also be considered an event of default by us under the relevant management agreement, giving the non-Brookdale party to the management agreement the right to pursue the remedies provided for in the management agreement, potentially including termination of the management agreement. Further, in the event of default on a loan, the lender may have the ability to terminate us as manager. With respect to communities held in ventures, in some cases, the management agreement can be terminated in connection with the sale by the venture partner of its interest in the venture or the sale of properties by the venture. Early termination of our management agreements or non-renewal or renewal on less-favorable terms could cause a loss in revenues and could negatively impact our results of operations and cash flows.

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, 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, and/or related regulatory proposals 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

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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 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

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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 (including legislative or regulatory efforts designed to address climate change, such as the proposed "cap and trade" legislation) 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 and healthcare industries. Certain claims and lawsuits allege large damage amounts and may require significant costs to defend and resolve. Similarly, the senior living and healthcare industries are continuously subject to scrutiny by governmental regulators, which could result in litigation related to regulatory compliance matters. As a result, we maintain general liability and professional liability 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, 2010, our current policies are written on a claims-made basis and provide for deductibles of \$150,000 for each claim. Accordingly, we are, in effect, self-insured for claims that are less than \$150,000. If we experience a greater number of losses than we anticipate, 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

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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 Act of 2005, or DRA 2005, every entity that receives at least \$5.0 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,

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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.

We face periodic and routine reviews, audits and investigations under our contracts with government agencies, and these audits could have adverse findings that may negatively impact our business.

As a result of our participation in the Medicare and Medicaid programs, we are subject to various governmental reviews, audits and investigations to verify our compliance with these programs and applicable laws and regulations. We also are subject to audits under various government programs, including but not limited to the RAC and ZPIC programs, in which third party firms engaged by CMS conduct extensive reviews of claims data and medical and other records to identify potential improper payments under the Medicare program. Our costs to respond to and defend reviews, audits and investigations may be significant and could have a material adverse effect on our business and consolidated financial condition, results of operations and cash flows. Moreover, an adverse review, audit or investigation could result in:

- required refunding or retroactive adjustment of amounts we have been paid pursuant to the federal or state programs;
  - state or federal agencies imposing fines, penalties and other sanctions on us;
  - loss of our right to participate in the Medicare program or state programs; or
    - damage to our business and reputation in various markets.

These results could have a material adverse effect on our business and consolidated financial condition, results of operations and cash flows.

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 and healthcare services businesses 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 or healthcare 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 sectors 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 affect 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, 2011, funds managed by affiliates of Fortress Investment Group LLC (“Fortress”) and various principals of Fortress, in the aggregate, beneficially own 20,091,326 shares, or approximately 16.6% of our outstanding common stock (excluding unvested restricted shares). In addition, two of our directors are associated with Fortress and, pursuant to our Stockholders Agreement, Fortress currently has the ability to require us to nominate two individuals designated by Fortress for election as members of our nine-member Board of Directors (subject to their election by our stockholders). As a result, Fortress may be able to substantially influence 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 substantial influence over 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;
- 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.

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 other payments from our subsidiaries to generate the funds necessary to meet our financial obligations. Our

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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 additional debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes, convertible securities, 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 or purchase plans or pursuant to the conversion or exercise features of our convertible senior notes and warrants) 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 December 31, 2011, 121,132,539 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. In connection with our obligations under the Stockholders Agreement, we have on file with the SEC an effective registration statement permitting the resale, from time to time, of up to 20,091,326 shares of common stock owned by certain affiliates and various principals of Fortress. The shares covered by the registration statement are freely transferable pursuant to the registration statement and by subsequent purchasers that are not our affiliates.

In addition, as of December 31, 2011, we had registered under the Securities Act an aggregate of 12,100,000 shares for issuance under our Omnibus Stock Incentive Plan, an aggregate of 1,000,000 shares for issuance under our Associate Stock Purchase Plan and an aggregate of 100,000 shares for issuance under our Director 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 automatically increases 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.

Our ability to use net operating loss carryovers to reduce future tax payments will be limited.

Section 382 of the Internal Revenue code contains rules that limit the ability of a company that undergoes an ownership change, which is generally any change in ownership of 50% of its stock over a three-year period, to utilize its net operating loss carryforward and certain built-in losses recognized in years after the ownership change. These rules generally operate by focusing on ownership changes involving stockholders owning directly or indirectly 5% or more of the stock of a company and any change in ownership arising from a new issuance of stock by the company. We have determined that an ownership change occurred within the second quarter of 2010, and, therefore, losses carried into the change period will be limited on a go forward basis. The annual limitation is equal to the product of the applicable long term tax exempt rate and the value of our stock immediately before the ownership change, adjusted for certain items. The annual limitation may be increased by certain built-in gains existing at the time of change. In addition to the 2010 ownership change, we have had previous ownership changes.

Item 1B. Unresolved Staff Comments.

None.

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## Item 2. Properties.

## Facilities

At December 31, 2011, we operated 647 communities across 36 states, with the capacity to serve approximately 67,100 residents. Of the communities we operated at December 31, 2011, we owned 200, we leased 350 pursuant to operating and capital leases, and 97 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, 2011:

State	Occupancy			Ownership Status			Total
	Units	Rate(1)(2)		Owned	Leased	Managed	
Florida	13,735	83.9	%	35	39	26	100
Texas	10,732	84.9	%	22	35	25	82
Colorado	3,676	91.3	%	6	17	8	31
California	3,440	88.6	%	13	6	3	22
Ohio	3,291	86.0	%	20	19	3	42
Illinois	3,238	89.4	%	1	9	4	14
North Carolina	3,209	92.0	%	3	51	1	55
Michigan	2,938	87.0	%	7	26	3	36
Arizona	2,550	87.2	%	3	11	5	19
Tennessee	1,627	93.1	%	15	7	2	24
Virginia	1,614	84.3	%	2	4	1	7
Kansas	1,468	90.3	%	10	11	2	23
Oklahoma	1,418	87.1	%	11	15	3	29
Alabama	1,307	94.6	%	2	5	1	8
Indiana	1,305	82.8	%	7	10	—	17
Rhode Island	1,184	85.0	%	—	5	4	9
New York	1,157	93.0	%	7	9	—	16
Washington	1,044	87.7	%	4	8	—	12
Pennsylvania	936	86.2	%	5	3	—	8
Missouri	926	90.6	%	2	1	—	3
Georgia	838	81.1	%	4	—	4	8
Oregon	765	97.4	%	4	8	—	12
Minnesota	723	90.7	%	—	16	1	17
South Carolina	625	79.5	%	4	8	—	12
Kentucky	582	88.0	%	—	1	1	2
Wisconsin	504	91.5	%	4	10	—	14
New Jersey	494	78.5	%	2	6	—	8
New Mexico	429	92.8	%	1	2	—	3
Connecticut	425	78.6	%	2	2	—	4
Massachusetts	280	85.0	%	1	—	—	1
Idaho	228	98.7	%	1	2	—	3
Nevada	147	90.5	%	—	2	—	2
New Hampshire	97	58.8	%	—	1	—	1
Louisiana	84	94.0	%	—	1	—	1
Delaware	54	98.1	%	1	—	—	1
Mississippi	37	78.4	%	1	—	—	1

Total	67,107	87.0	%	200	350	97	647
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- (1) Includes the impact of managed properties.
- (2) Represents occupancy at the end of the period.

Substantially all of our owned properties are subject to mortgages.

#### Corporate Offices

Our main corporate offices are all leased, including our 73,358 square foot facility in Nashville, Tennessee, our 117,609 square foot facility in Milwaukee, Wisconsin, and our 31,845 square foot facility in Chicago, Illinois.

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Item 3. Legal Proceedings.

The information contained in Note 23 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. (Removed and Reserved).

Executive Officers of the Registrant

The following table sets forth certain information concerning our executive officers as of February 28, 2012:

Name	Age	Position
W.E. Sheriff	69	Chief Executive Officer
Mark W. Ohlendorf	51	Co-President and Chief Financial Officer
John P. Rijos	59	Co-President and Chief Operating Officer
T. Andrew Smith	51	Executive Vice President, General Counsel and Secretary
Bryan D. Richardson	53	Executive Vice President and Chief Administrative Officer
Gregory B. Richard	57	Executive Vice President – Field Operations
Kristin A. Ferge	38	Executive Vice President and Treasurer
George T. Hicks	54	Executive Vice President – Finance
H. Todd Kaestner	56	Executive Vice President – Corporate Development

W.E. Sheriff has served as our Chief Executive Officer since February 2008 and as a member of our Board of Directors since January 2010. 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. 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 currently serves as the chairman 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

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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.

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 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.

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.

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 for each quarter for the last two fiscal years.



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	Fiscal 2011	
	High	Low
First Quarter	\$ 28.23	\$ 20.90
Second Quarter	\$ 28.30	\$ 21.97
Third Quarter	\$ 25.51	\$ 12.27
Fourth Quarter	\$ 17.54	\$ 10.98

  

	Fiscal 2010	
	High	Low
First Quarter	\$ 22.21	\$ 16.21
Second Quarter	\$ 22.19	\$ 14.84
Third Quarter	\$ 16.44	\$ 12.66
Fourth Quarter	\$ 21.70	\$ 15.93

The closing sale price of our common stock as reported on the NYSE on February 23, 2012 was \$18.98 per share. As of that date, there were approximately 465 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 and no dividends were declared during the last two fiscal years. Although we anticipate that, over the longer-term, we may pay regular quarterly dividends to the holders of our common stock, over the near term we are focused on preserving liquidity and deploying capital in the growth of our business. Accordingly, we do not expect to pay cash dividends on our common stock for the foreseeable future.

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, 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 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.

#### 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., Alterra Healthcare Corporation and American Retirement Corporation for all periods presented. 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, 2011 have been derived from our audited financial statements.

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	For the Years Ended December 31,				
	2011	2010	2009	2008	2007
Fiscal Year ended December 31, (in thousands, except per share and other operating data)					
Total revenue	\$2,457,918	\$2,280,535	\$2,100,274	\$2,001,304	\$1,905,697
Facility operating expense	1,508,571	1,437,930	1,302,277	1,261,581	1,170,937
General and administrative expense	148,327	131,709	134,864	140,919	138,013
Facility lease expense	274,858	270,905	272,096	269,469	271,628
Depreciation and amortization	268,506	292,341	271,935	276,202	299,925
Facility lease termination expense		4,608			
(Gain) loss on sale of communities, net		(3,298 )	2,043		
Gain on acquisition	(1,982 )				
Goodwill and asset impairment	16,892	13,075	10,073	220,026	
Costs incurred on behalf of unconsolidated ventures	152,566	67,271	77,206	73,250	66,401
Total operating expense	2,367,738	2,214,541	2,070,494	2,241,447	1,946,904
Income (loss) from operations	90,180	65,994	29,780	(240,143 )	(41,207 )
Interest income	3,538	2,238	2,354	7,618	7,519
Interest expense:					
Debt	(124,873 )	(132,641 )	(128,869 )	(147,389 )	(143,991 )
Amortization of deferred financing costs and debt discount	(13,427 )	(8,963 )	(9,505 )	(9,707 )	(7,064 )
Change in fair value of derivatives and amortization	(3,878 )	(4,118 )	3,765	(68,146 )	(73,222 )
Loss on extinguishment of debt, net	(18,863 )	(1,557 )	(1,292 )	(3,052 )	(2,683 )
Equity in earnings (loss) of unconsolidated ventures	1,432	168	440	(861 )	(3,386 )
Other non-operating income (expense)	56	(1,454 )	4,146	1,708	402
Loss before income taxes	(65,835 )	(80,333 )	(99,181 )	(459,972 )	(263,632 )
(Provision) benefit for income taxes	(2,340 )	31,432	32,926	86,731	101,260
Net loss	(68,175 )	(48,901 )	(66,255 )	(373,241 )	(162,372 )
Net loss attributable to noncontrolling interest				—	393
Net loss attributable to common stockholders	\$(68,175 )	\$(48,901 )	\$(66,255 )	\$(373,241 )	\$(161,979 )
Basic and diluted loss per share from operations attributable to common stockholders					
	\$(0.56 )	\$(0.41 )	\$(0.60 )	\$(3.67 )	\$(1.60 )
Weighted average shares of common stock used in computing basic and diluted loss per share					
	121,161	120,010	111,288	101,667	101,511
Dividends declared per share of common stock					
	\$	\$	\$	\$0.75	\$1.95

Other Operating Data:

Total number of facilities (at end of period)	647	559	565	548	550
Total units operated(1)(2)					
Period end	66,183	50,521	51,021	49,145	51,162
Weighted average	55,548	50,870	49,536	49,165	50,950
Occupancy rate (weighted average) (2)	87.3	% 87.1	% 86.5	% 87.6	% 90.6
Average monthly revenue per unit(2)(3)	\$4,612	\$4,439	\$4,253	\$4,031	\$3,577

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(in thousands)	As of December 31,				
	2011	2010	2009	2008	2007
Cash and cash equivalents	\$30,836	\$81,827	\$66,370	\$53,973	\$100,904
Total assets	\$4,466,061	\$4,530,470	\$4,649,879	\$4,449,258	\$4,811,622
Total debt	\$2,463,625	\$2,570,296	\$2,625,526	\$2,552,929	\$2,335,224
Total stockholders' equity	\$1,040,208	\$1,059,997	\$1,086,582	\$960,601	\$1,419,538

- (1) Period end units operated excludes equity homes. Weighted average units operated represents the average units operated during the period, excluding equity homes.
- (2) Beginning in 2010, total units operated, occupancy rates and average monthly revenue per unit are reported using an average unit methodology based on a consistent treatment of units across all product lines, as compared to the historical method where occupancy was reported based upon unit calculations that varied by product line. Total units operated, occupancy rates and average monthly revenue per unit for 2009 and 2008 have been recast to conform to the current presentation. However, total units operated, occupancy rates and average monthly revenue per unit for 2007 have not been recast as it was not practical to do so. As a result, total units operated, occupancy rates and average monthly revenue per unit for 2007 do not reflect the new average unit methodology adopted in 2010 and are not comparable to 2011, 2010, 2009 and 2008.
- (3) Average monthly revenue per unit represents the average of the total monthly revenues, excluding amortization of entrance fees, divided by average occupied units.

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

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 2011, we continued to make progress in implementing our long-term growth strategy, integrating 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 of economies of scale; (ii) continued expansion of our ancillary services programs (including therapy, home health and hospice services); (iii) expansion, redevelopment and repositioning of existing communities; and (iv) acquisition and consolidation of asset portfolios and other senior living companies. To that end, as described below, during 2011, we acquired 100% of the equity interests in Horizon Bay, the then-ninth largest operator of senior living communities in the United States.

Our operating results for the year ended December 31, 2011 were favorably impacted by an increase in our total revenues, primarily driven by an increase in average monthly revenue per unit, including an increase in our ancillary

services revenue, as well as the inclusion of revenue from recent acquisitions. Although we have made significant progress in many areas of our business, the difficult operating environment has continued to result in occupancy rates that are lower than historical levels and diminished growth in the rates we charge our residents.

During 2011, we continued our efforts to strengthen our financial position. For example, on January 31, 2011, we entered into an amended and restated credit agreement with General Electric Capital Corporation, as administrative agent and lender, and the other lenders from time to time parties thereto. The amended credit

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agreement amended and restated our previous credit agreement. The amended credit agreement increased the commitment under the credit facility to \$200.0 million and extended the maturity date to January 31, 2016. Effective February 23, 2011, the commitment under the amended credit agreement was further increased to \$230.0 million. In addition, during the second quarter, we completed a registered offering of \$316.3 million aggregate principal amount of 2.75% convertible senior notes due 2018. The net proceeds from the offering were used to repay a portion of our outstanding mortgage debt. We ended the year with \$30.8 million of unrestricted cash and cash equivalents on our consolidated balance sheet and \$194.2 million of availability on our revolving credit facility (of which \$65.0 million had been drawn as of December 31, 2011).

The table below presents a summary of our operating results and certain other financial metrics for the years ended December 31, 2011 and 2010 and the amount and percentage of increase or decrease of each applicable item (dollars in millions).

	Years Ended December 31,		Increase (Decrease)		
	2011	2010	Amount	Percent	
Total revenue	\$ 2,457.9	\$ 2,280.5	\$ 177.4	7.8	%
Net loss(1)	\$ (68.2 )	\$ (48.9 )	\$ 19.3	39.4	%
Adjusted EBITDA	\$ 402.7	\$ 408.5	\$ (5.8 )	(1.4)	)%
Cash From Facility Operations	\$ 239.9	\$ 240.7	\$ (0.8 )	(0.3)	)%
Facility Operating Income	\$ 757.8	\$ 744.3	\$ 13.5	1.8	%

(1) Net loss for 2011 and 2010 includes non-cash impairment charges of \$16.9 million and \$13.1 million, respectively.

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, 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.

Our revenues for the year ended December 31, 2011 increased to approximately \$2.5 billion, an increase of \$177.4 million, or 7.8%, over our revenues for the year ended December 31, 2010. The increase in revenues in the current year was primarily a result of an increase in the average monthly revenue per unit compared to the prior year, including growing revenues from our ancillary services programs and the inclusion of revenue from recent acquisitions. Our weighted average occupancy for the year ended December 31, 2011 and 2010 was 87.3% and 87.1%, respectively. Beginning with the first quarter of 2010, occupancy rates and average monthly revenue per unit are being reported using the average unit methodology. Occupancy rates and average monthly revenue per unit for all prior periods have been recast to conform to the current presentation.

During the year ended December 31, 2011, our Adjusted EBITDA and Cash From Facility Operations decreased by 1.4% and 0.3%, respectively, and Facility Operating Income increased by 1.8% when compared to the year ended December 31, 2010.

During 2011, we continued to expand our ancillary services offerings. As of December 31, 2011, we offered therapy services to approximately 36,200 of our units and home health services to approximately 29,000 of our units. We continue to see positive results from the maturation of previously-opened therapy and home health clinics. We also expect to continue to expand our ancillary services programs to additional units and to open or acquire additional

home health agencies.

On September 1, 2011, we completed the acquisition of 100% of the equity interests in Horizon Bay. As a result of the transaction, we added to our portfolio 91 communities with over 16,200 units in 19 states.

In connection with the acquisition, we restructured Horizon Bay's existing relationship with HCP, Inc. ("HCP") relating to 33 communities that Horizon Bay leased from HCP. First, we formed a joint venture with HCP to own and operate 21 of the communities utilizing a RIDEA structure. We acquired a 10% interest in the RIDEA joint venture. We also manage the communities under a ten-year management agreement with four five-year renewal



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options and will retain all ancillary services operations. The 21-community portfolio has a total of 5,000 units (approximately 4,206 independent living, 721 assisted living, and 73 Alzheimer's/dementia care units) and is primarily located in Florida, Texas, Illinois and Rhode Island.

Second, we entered into long term, triple net leases with HCP relating to 12 communities with a total of 1,546 units (approximately 578 independent living, 595 assisted living, 217 Alzheimer's/dementia care and 156 skilled nursing units). The leased portfolio is primarily located in Texas and Rhode Island.

We also provide management services to the remaining 58 Horizon Bay communities, which contain approximately 9,667 units, consisting of 5,527 independent living units, 3,174 assisted living units, 477 Alzheimer's/dementia care units and 489 skilled nursing beds in 15 states. The management contracts are generally long-term agreements with base management fees and potential incentive fees. In conjunction with the acquisition, we entered into an agreement to restructure the management agreements with Chartwell Seniors Housing Real Estate Investment Trust ("Chartwell") relating to 45 of these communities (with a total of 6,359 units). As part of the restructuring of the management agreements, Chartwell granted us an option through 2013 to acquire a 20% interest in Chartwell's U.S. real estate assets that we manage. We also have a right of first offer to acquire any of Chartwell's assets that we manage.

Certain elements of the Chartwell management arrangement restructuring are subject to lender and other third party approvals. Until such approvals are received, we will operate Chartwell's properties under the existing management contracts.

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 lower occupancy rates and occupancy levels when compared to historical levels. We remain cautious about the economy and its 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 and entrance fee sales to normalize over the longer term.

Consolidated Results of Operations

Year Ended December 31, 2011 and 2010

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.

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

(dollars in thousands, except average monthly revenue per unit)	Years Ended		Increase	
	December 31,		(Decrease)	
	2011	2010	Amount	Percent
Statement of Operations Data:				
Total revenue				
Resident fees				

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Retirement Centers	\$526,207	\$530,161	\$(3,954)	(0.7	%)
Assisted Living	1,063,155	1,023,785	39,370	3.8	%
CCRCs	702,395	653,727	48,668	7.4	%
Total resident fees	2,291,757	2,207,673	84,084	3.8	%
Management services(1)	166,161	72,862	93,299	128.0	%
Total revenue	2,457,918	2,280,535	177,383	7.8	%

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(dollars in thousands, except average monthly revenue per unit)	Years Ended December 31,		Increase (Decrease)		
	2011	2010	Amount	Percent	
<b>Expense</b>					
<b>Facility operating expense</b>					
Retirement Centers	313,379	311,345	2,034	0.7	%
Assisted Living	695,464	661,859	33,605	5.1	%
CCRCs	499,728	464,726	35,002	7.5	%
Total facility operating expense	1,508,571	1,437,930	70,641	4.9	%
General and administrative expense	148,327	131,709	16,618	12.6	%
Facility lease expense	274,858	270,905	3,953	1.5	%
Depreciation and amortization	268,506	292,341	(23,835 )	(8.2	%)
Gain on sale of communities, net	—	(3,298 )	3,298	100.0	%
Asset impairment	16,892	13,075	3,817	29.2	%
Gain on acquisition	(1,982 )		1,982	100.0	%
Facility lease termination expense	—	4,608	(4,608 )	(100.0	%)
Costs incurred on behalf of managed communities	152,566	67,271	85,295	126.8	%
Total operating expense	2,367,738	2,214,541	153,197	6.9	%
Income from operations	90,180	65,994	24,186	36.6	%
Interest income	3,538	2,238	1,300	58.1	%
<b>Interest expense:</b>					
Debt	(124,873 )	(132,641 )	(7,768 )	(5.9	%)
Amortization of deferred financing costs and debt discount	(13,427 )	(8,963 )	4,464	49.8	%
Change in fair value of derivatives and amortization	(3,878 )	(4,118 )	(240 )	(5.8	%)
Loss on extinguishment of debt, net	(18,863 )	(1,557 )	17,306		NM
Equity in earnings of unconsolidated ventures	1,432	168	1,264	752.4	%
Other non-operating income (expense)	56	(1,454 )	1,510	103.9	%
Loss before income taxes	(65,835 )	(80,333 )	(14,498 )	(18.0	%)
(Provision) benefit for income taxes	(2,340 )	31,432	(33,772 )	(107.4	%)
Net loss	\$(68,175 )	\$(48,901 )	\$19,274	39.4	%
<b>Selected Operating and Other Data:</b>					
Total number of communities (period end)	647	559	88	15.7	%
<b>Total units operated(2)</b>					
Period end	66,183	50,521	15,662	31.0	%
Weighted average	55,548	50,870	4,678	9.2	%
<b>Owned/leased communities units(2)</b>					
Period end	47,895	46,735	1,160	2.5	%
Weighted average	46,912	47,083	(171 )	(0.4	%)
<b>Owned/leased communities occupancy rate (weighted average)</b>					
	87.3	% 87.1	% 0.2	% 0.2	%
Average monthly revenue per unit(3)	\$4,612	\$4,439	\$173	3.9	%
<b>Selected Segment Operating and Other Data</b>					
<b>Retirement Centers</b>					
Number of communities (period end)	76	78	(2 )	(2.6	%)
<b>Total units(2)</b>					
Period end	14,468	14,525	(57 )	(0.4	%)
Weighted average	14,188	14,700	(512 )	(3.5	%)

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Occupancy rate (weighted average)	88.0	%	87.2	%	0.8	%	0.9	%
Average monthly revenue per unit(3)	\$3,513		\$3,445		\$68		2.0	%
Assisted Living								
Number of communities (period end)	434		427		7		1.6	%
Total units(2)								
Period end	21,630		20,945		685		3.3	%
Weighted average	21,323		21,109		214		1.0	%
Occupancy rate (weighted average)	88.2	%	88.4	%	(0.2	%)	(0.2	%)

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(dollars in thousands, except average monthly revenue per unit)	Years Ended December 31,		Increase (Decrease)		
	2011	2010	Amount	Percent	
Average monthly revenue per unit(3)	\$4,712	\$4,573	\$139	3.0	%
<b>CCRCs</b>					
Number of communities (period end)	40	35	5	14.3	%
<b>Total units(2)</b>					
Period end	11,797	11,265	532	4.7	%
Weighted average	11,401	11,274	127	1.1	%
Occupancy rate (weighted average)	84.8	% 84.3	% 0.5	% 0.6	%
Average monthly revenue per unit(3)	\$5,838	\$5,517	\$321	5.8	%
<b>Management Services</b>					
Number of communities (period end)	97	19	78	410.5	%
<b>Total units(2)</b>					
Period end	18,288	3,786	14,502	383.0	%
Weighted average	8,636	3,787	4,849	128.0	%
Occupancy rate (weighted average)	84.5	% 83.8	% 0.7	% 0.8	%

**Selected Entrance Fee**

Data:	2011				
	Q1	Q2	Q3	Q4	YTD
<b>Non-refundable entrance fees sales</b>	\$ 6,361	\$ 9,299	\$ 10,815	\$ 11,903	\$ 38,378
Refundable entrance fees sales(4)	6,080	5,310	7,204	11,017	29,611
<b>Total entrance fee receipts(5)</b>	12,441	14,609	18,019	22,920	67,989
Refunds	(4,930 )	(6,481 )	(5,475 )	(8,868 )	(25,754 )
<b>Net entrance fees</b>	\$ 7,511	\$ 8,128	\$ 12,544	\$ 14,052	\$ 42,235

	2010				
	Q1	Q2	Q3	Q4	YTD
<b>Non-refundable entrance fees sales</b>	\$ 9,550	\$ 8,354	\$ 9,812	\$ 9,770	\$ 37,486
Refundable entrance fees sales(4)	8,442	6,619	12,242	9,117	36,420
<b>Total entrance fee receipts(5)</b>	17,992	14,973	22,054	18,887	73,906
Refunds	(5,762 )	(5,360 )	(4,984 )	(4,954 )	(21,060 )
<b>Net entrance fees</b>	\$ 12,230	\$ 9,613	\$ 17,070	\$ 13,933	\$ 52,846

(1) Management services segment revenue includes reimbursements for which we are the primary obligor of costs incurred on behalf of managed communities.

(2) Period end units operated excludes equity homes. Weighted average units operated represents the average units operated during the period, excluding equity homes.

- (3) Average monthly revenue per unit represents the average of the total monthly revenues, excluding amortization of entrance fees, divided by average occupied units.
- (4) Refundable entrance fee sales for the years ended December 31, 2011 and 2010 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 residents totaled \$1.1 million, \$1.6 million, \$2.3 million and \$4.0 million in the first, second, third and fourth quarters of 2011, respectively, and \$0.1 million, \$0.2 million, \$6.5 million and \$3.8 million in the first, second, third and fourth quarters of 2010, respectively.
- (5) Includes \$12.6 million and \$18.5 million of first generation entrance fee receipts (which represent initial entrance fees received from the sale of units at a recently opened entrance fee CCRC) during the year ended December 31, 2011 and 2010, respectively.

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As of December 31, 2011, our total operations included 647 communities with a capacity to serve 67,107 units.

### Resident Fees

Resident fees increased over the prior-year principally due to an increase in average monthly revenue per unit during the current year, including an increase in our ancillary services revenue as we continued to roll out therapy and home health services to many of our communities, as well as the inclusion of revenue from recent acquisitions. During the current year, revenues grew 3.1% at the 531 communities we operated during both periods with a 3.3% increase in the average monthly revenue per unit (excluding amortization of entrance fees in both instances). Occupancy decreased 0.2% in these communities year over year.

Retirement Centers revenue decreased \$4.0 million, or 0.7%, primarily due to the reclassification of three communities out of this segment during the first quarter of the current year as well as the sale of two communities during the current year. The decrease in revenue was partially offset by increases in average monthly revenue per unit, including an increase in ancillary services revenue, and occupancy at the communities we operated during both years, as well as the inclusion of revenue from communities acquired in the current year.

Assisted Living revenue increased \$39.4 million, or 3.8%, primarily due to an increase in the average monthly revenue per unit, including an increase in ancillary services revenue, as well as the reclassification of three communities from the Retirement Centers segment into this segment during the current year and the inclusion of revenue from communities acquired in the current year. This increase was partially offset by a decrease in occupancy at the communities we operated during both years and the impact of the disposition of two communities during the current year.

CCRCs revenue increased \$48.7 million, or 7.4%, primarily due to an increase in the average monthly revenue per unit, including an increase in our ancillary services revenue, and an increase in revenue from newly opened units as well as the inclusion of revenue from communities acquired in the current year. This increase was partially offset by a decrease in occupancy at the communities we operated during both years.

### Management Services

Management services revenue, including reimbursed costs incurred on behalf of managed communities, increased \$93.3 million, or 128.0%, primarily due to the management agreements entered into or acquired in conjunction with the Horizon Bay and HCP transactions. In the current year, we added 78 new managed communities in connection with these transactions.

### Facility Operating Expense

Facility operating expense increased over the prior-year primarily due to an increase in salaries and wages, additional current year expense incurred in connection with the continued expansion of our ancillary services programs during 2010 and 2011, increased payroll taxes and workers compensation expense, as well as the inclusion of expenses from communities acquired during the current year. These increases were partially offset by decreases in real estate tax expense related to changes in estimates, bad debt expense and lighting retrofit costs.

Retirement Centers operating expenses increased \$2.0 million, or 0.7%, primarily due to an increase in expenses incurred in connection with the continued expansion of our ancillary services programs, increases in salaries and wages due to wage rate increases and an increase in hours worked year over year, increases in payroll taxes, food expense, workers compensation expense and the inclusion of expenses from communities acquired in the current

year. These increases were partially offset by the reclassification of three communities out of this segment during the current year as well as decreases in real estate taxes related to changes in estimates and lighting retrofit costs.

Assisted Living operating expenses increased \$33.6 million, or 5.1%, primarily due to an increase in expenses incurred in connection with the continued expansion of our ancillary services programs, increased salaries and wages due to wage rate increases and an increase in hours worked year over year as well as the reclassification of three communities from the Retirement Centers segment into this segment during the current year. Assisted Living operating expenses were also impacted by increases in payroll taxes and workers compensation expense



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and the inclusion of expenses from communities acquired in the current year. These increases were partially offset by decreases in real estate tax expense.

CCRCs operating expenses increased \$35.0 million, or 7.5%, primarily due to an increase in expenses incurred in connection with our ancillary services programs, increased salaries and wages due to wage rate increases and an increase in hours worked year over year and the inclusion of expenses from communities acquired in the current year. CCRCs operating expenses were also impacted by increases in payroll taxes, health care supply expense, employee benefits and workers compensation expenses. These increases were partially offset by decreases in bad debt expense and lighting retrofit costs.

#### General and Administrative Expense

General and administrative expense increased \$16.6 million, or 12.6%, primarily as a result of increased salaries and wages, payroll taxes, employee benefits, travel expenses and integration and transaction-related costs, partially offset by a decrease in corporate expense allocations. General and administrative expense as a percentage of total revenue, including revenue generated by the communities we manage and excluding non-cash stock-based compensation expense and integration and transaction-related costs, was 4.4% and 4.7% for the years ended December 31, 2011 and 2010, respectively, calculated as follows (dollars in thousands):

	Year Ended December 31,							
	2011			2010				
Resident fee revenues	\$	2,291,757	88.3	%	\$	2,207,673	94.1	%
Resident fee revenues under management		304,717	11.7	%		139,478	5.9	%
<b>Total</b>	<b>\$</b>	<b>2,596,474</b>	<b>100</b>	<b>%</b>	<b>\$</b>	<b>2,347,151</b>	<b>100</b>	<b>%</b>
General and administrative expenses (excluding non-cash stock-based compensation expense and integration and transaction-related costs)	\$	114,083	4.4	%	\$	110,950	4.7	%
Non-cash stock-based compensation expense		19,856	0.8	%		20,759	0.9	%
Integration and transaction-related costs		14,388	0.6	%			0.0	%
<b>General and administrative expenses (including non-cash stock-based compensation expense and integration and transaction-related costs)</b>	<b>\$</b>	<b>148,327</b>	<b>5.7</b>	<b>%</b>	<b>\$</b>	<b>131,709</b>	<b>5.6</b>	<b>%</b>

#### Facility Lease Expense

Facility lease expense increased \$4.0 million, or 1.5%, primarily due to normal operating lease expense escalations and the acquisition of 12 leased properties in conjunction with the Horizon Bay and HCP transactions. The increase was partially offset by the purchase of four leased communities and the non-renewal of two leased communities that occurred late in the prior year.

### Depreciation and Amortization

Depreciation and amortization expense decreased by \$23.8 million, or 8.2%, primarily as a result of the management contract and therapy services intangibles related to a 2006 acquisition becoming fully amortized during the current year, as well as in-place lease intangibles from prior acquisitions and furniture and equipment becoming fully amortized during the current year.

### Asset Impairment

During 2011 and 2010, we recognized \$16.9 million and \$13.1 million, respectively, of impairment charges related to asset impairments for property, plant and equipment and leasehold intangibles for certain communities within the Assisted Living and Retirement Center segments. We compared the estimated fair value of the assets to their carrying value and recorded an impairment charge for the excess of carrying value over estimated fair value.

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Gain on Acquisition

During 2011, we recognized \$2.0 million as a gain on acquisition related to the acquisition of Horizon Bay. See Note 4 to the consolidated financial statements contained in Part II, Item 8 of this Annual Report on Form 10-K, which is incorporated herein by reference, for further detail.

Costs Incurred on Behalf of Managed Communities

Costs incurred on behalf of managed communities increased \$85.3 million, or 126.8%, primarily due to management agreements entered into or acquired in conjunction with the Horizon Bay and HCP transactions. We added 78 new managed communities in connection with these transactions.

Interest Income

Interest income increased \$1.3 million, or 58.1%, primarily due to increased interest income earned on our restricted marketable securities.

Interest Expense

Interest expense decreased \$3.5 million, or 2.4%, primarily due to a decrease in interest expense on our mortgage debt due to lower average outstanding debt year over year. The decrease was partially offset by additional expense from the amortization of our debt discount primarily on our convertible notes issued during 2011 and higher interest cost related to our line of credit which had a higher average outstanding balance drawn year over year.

Loss on Extinguishment of Debt, net

During 2011, we recognized \$18.9 million as a loss on extinguishment of debt, related to costs incurred in connection with the early repayment of first and second mortgage notes.

Income Taxes

The reduction in the income tax benefit over the prior year is due to a decrease in the effective tax rate from 39.1% in 2010 to (3.6)% in 2011. This decrease is primarily due to the impact of our decision to record a valuation allowance against the deferred tax benefit generated during 2011.

Year Ended December 31, 2010 and 2009

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.

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

(dollars in thousands, except average monthly revenue per unit)	Years Ended December 31,		Increase (Decrease)	
	2010	2009	Amount	Percent

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Statement of Operations Data:

Total revenue

Resident fees

Retirement Centers	\$ 530,161	\$ 496,744	\$ 33,417	6.7	%
Assisted Living	1,023,785	925,917	97,868	10.6	%
CCRCs	653,727	593,688	60,039	10.1	%
Total resident fees	2,207,673	2,016,349	191,324	9.5	%

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(dollars in thousands, except average monthly revenue per unit)	Years Ended December 31,		Increase (Decrease)	
	2010	2009	Amount	Percent
Management services(1)	72,862	83,925	(11,063 )	(13.2 %)
Total revenue	2,280,535	2,100,274	180,261	8.6 %
<b>Expense</b>				
<b>Facility operating expense</b>				
Retirement Centers	311,345	283,136	28,209	10.0 %
Assisted Living	661,859	600,948	60,911	10.1 %
CCRCs	464,726	418,193	46,533	11.1 %
Total facility operating expense	1,437,930	1,302,277	135,653	10.4 %
General and administrative expense	131,709	134,864	(3,155 )	(2.3 %)
Facility lease expense	270,905	272,096	(1,191 )	(0.4 %)
Depreciation and amortization	292,341	271,935	20,406	7.5 %
(Gain) loss on sale of communities, net	(3,298 )	2,043	(5,341 )	(261.4 %)
Asset impairment	13,075	10,073	3,002	29.8 %
<b>Costs incurred on behalf of managed communities</b>				
Facility lease termination expense	4,608	77,206	(9,935 )	(12.9 %)
Total operating expense	2,214,541	2,070,494	144,047	7.0 %
Income from operations	65,994	29,780	36,214	121.6 %
Interest income	2,238	2,354	(116 )	(4.9 %)
<b>Interest expense:</b>				
Debt	(132,641 )	(128,869 )	3,772	2.9 %
Amortization of deferred financing costs and debt discount	(8,963 )	(9,505 )	(542 )	(5.7 %)
Change in fair value of derivatives and amortization	(4,118 )	3,765	(7,883 )	(209.4 %)
Loss on extinguishment of debt, net	(1,557 )	(1,292 )	265	20.5 %
<b>Equity in earnings of unconsolidated ventures</b>				
Other non-operating income	168	440	(272 )	(61.8 %)
Loss before income taxes	(1,454 )	4,146	(5,600 )	(135.1 %)
Benefit for income taxes	(80,333 )	(99,181 )	(18,848 )	(19.0 %)
Net loss	31,432	32,926	(1,494 )	(4.5 %)
	\$ (48,901 )	\$ (66,255 )	\$ (17,354 )	(26.2 %)
<b>Selected Operating and Other Data:</b>				
Total number of communities (period end)	559	565	(6 )	(1.1 %)
<b>Total units operated(2)</b>				
Period end	50,521	51,021	(500 )	(1.0 %)
Weighted average	50,870	49,536	1,334	2.7 %
<b>Owned/leased communities units(2)</b>				
Period end	46,735	46,881	(146 )	(0.3 %)
Weighted average	47,083	45,174	1,909	4.2 %
<b>Owned/leased communities occupancy rate (weighted average)</b>				
	87.1 %	86.5 %	0.6 %	0.7 %
Average monthly revenue per unit(3)	\$ 4,439	\$ 4,253	\$ 186	4.4 %
<b>Selected Segment Operating and Other Data</b>				

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Retirement Centers

Number of communities (period end)	78	80	(2 )	(2.5 %)
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Total units(2)

Period end	14,525	14,396	129	0.9 %
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Weighted average	14,700	14,137	563	4.0 %
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Occupancy rate (weighted average)	87.2 %	87.2 %		
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Average monthly revenue per unit(3)	\$ 3,445	\$ 3,358	\$ 87	2.6 %
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Assisted Living

Number of communities (period end)	427	430	(3 )	(0.7 %)
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Total units(2)

Period end	20,945	21,173	(228 )	(1.1 %)
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dollars in thousands, except average monthly revenue per unit)	Years Ended December 31,				Increase (Decrease)	
	2010	2009	Amount	Percent		
Weighted average	21,109	20,201	908	4.5	%	
Occupancy rate (weighted average)	88.4	% 86.8	% 1.6	% 1.8	%	
Average monthly revenue per unit(3)	\$4,573	\$4,401	\$172	3.9	%	
<b>CCRCs</b>						
Number of communities (period end)	35	36	(1	)	(2.8	%)
<b>Total units(2)</b>						
Period end	11,265	11,312	(47	)	(0.4	%)
Weighted average	11,274	10,836	438	4.0	%	
Occupancy rate (weighted average)	84.3	% 85.1	% (0.8	%)	(0.9	%)
Average monthly revenue per unit(3)	\$5,517	\$5,168	\$349	6.8	%	
<b>Management Services</b>						
Number of communities (period end)	19	19				
<b>Total units(2)</b>						
Period end	3,786	4,140	(354	)	(8.6	%)
Weighted average	3,787	4,362	(575	)	(13.2	%)
Occupancy rate (weighted average)	83.8	% 84.2	% (0.4	%)	(0.5	%)

## Selected Entrance Fee

Data:	2010				
	Q1	Q2	Q3	Q4	YTD
<b>Non-refundable entrance fees sales</b>	\$ 9,550	\$ 8,354	\$ 9,812	\$ 9,770	\$ 37,486
Refundable entrance fees sales(4)	8,442	6,619	12,242	9,117	36,420
<b>Total entrance fee receipts(5)</b>	17,992	14,973	22,054	18,887	73,906
Refunds	(5,762 )	(5,360 )	(4,984 )	(4,954 )	(21,060 )
<b>Net entrance fees</b>	\$ 12,230	\$ 9,613	\$ 17,070	\$ 13,933	\$ 52,846
	2009				
	Q1	Q2	Q3	Q4	YTD
<b>Non-refundable entrance fees sales</b>	\$ 4,872	\$ 5,718	\$ 12,635	\$ 15,264	\$ 38,489
Refundable entrance fees sales(4)	3,638	4,098	9,296	13,354	30,386
<b>Total entrance fee receipts(5)</b>	8,510	9,816	21,931	28,618	68,875
Refunds	(5,836 )	(6,357 )	(4,649 )	(6,074 )	(22,916 )
<b>Net entrance fees</b>	\$ 2,674	\$ 3,459	\$ 17,282	\$ 22,544	\$ 45,959

(1) Management services segment revenue includes reimbursements for which we are the primary obligor of costs incurred on behalf of managed communities.

- (2) Period end units operated excludes equity homes. Weighted average units operated represents the average units operated during the period, excluding equity homes.
- (3) Average monthly revenue per unit represents the average of the total monthly revenues, excluding amortization of entrance fees, divided by average occupied units.
- (4) Refundable entrance fee sales for the years ended December 31, 2010 and 2009 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 residents totaled \$0.1 million, \$0.2 million, \$6.5 million and \$3.8 million in the first, second, third and fourth quarters of 2010, respectively, and \$0.6 million, \$0.1 million and \$0.4 million in the first, third and fourth quarters of 2009, respectively. My Choice amounts for the second quarter of 2009 were not material.



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(5) Includes \$18.5 million and \$25.7 million of first generation entrance fee receipts (which represent initial entrance fees received from the sale of units at a newly opened entrance fee CCRC) during the year ended December 31, 2010 and 2009, respectively.

As of December 31, 2010, our total operations included 559 communities with a capacity to serve 51,313 units.

### Resident Fees

The increase in resident fees occurred across all segments. Resident fees increased over the prior-year principally due to an increase in average monthly revenue per unit during 2010, including an increase in our ancillary services revenue as we continued to roll out therapy and home health services to many of our communities, the inclusion of revenue from recent acquisitions and expansions, and an increase in occupancy. During 2010, revenues grew 3.2% at the 510 communities we operated during both periods with a 2.9% increase in the average monthly revenue per unit (excluding amortization of entrance fees in both instances). Occupancy increased 0.3% in these communities year over year.

Retirement Centers revenue increased \$33.4 million, or 6.7%, primarily due to an increase in the average monthly revenue per unit at the communities we operated in both years. Occupancy at these communities remained consistent year over year.

Assisted Living revenue increased \$97.9 million, or 10.6%, primarily due to the inclusion of acquisitions that occurred close to the end of the prior period. The revenue increase was also due to increases in occupancy at the communities we operated during both periods, as well as increases in the average monthly revenue per unit, including an increase in ancillary services revenue, in these communities.

CCRCs revenue increased \$60.0 million, or 10.1%, primarily due to the inclusion of expansions that opened late in the prior period and an increase in the average monthly revenue per unit, including an increase in our ancillary services revenue, at the communities we operated during both periods, partially offset by a decrease in occupancy at these same communities year over year.

### Management Services

Management services revenue, including reimbursed costs incurred on behalf of managed communities, decreased \$11.1 million, or 13.2%, primarily attributable to four management agreements being terminated late in the prior year. The decrease was partially offset by the commencement of a new management agreement in mid-2009. Three of the terminated management agreements were attributed to us acquiring the remaining interest in the communities that we previously managed.

### Facility Operating Expense

Facility operating expense increased over the prior-year primarily due to the inclusion of expenses from recent acquisitions and expansions, an increase in salaries and wages, and additional expense incurred in connection with the continued expansion of our ancillary services programs. These increases were partially offset by a decrease in insurance expense related to changes in estimates and reduced workers compensation expenses.

Retirement Centers operating expenses increased \$28.2 million, or 10.0%, primarily due to the inclusion of expenses from acquisitions that occurred late in the fourth quarter of 2009 and an increase in expenses incurred in connection with the continued expansion of our ancillary services programs. Facility operating expenses were also negatively

impacted by increased salaries and wages due to wage rate increases, an increase in hours worked year over year and an increase in the amount of direct resident lease origination costs recognized. Additional expenses were incurred due to lighting retrofit costs related to an initiative to use more energy efficient lighting in our communities. These increases were partially offset by a decrease in insurance expense related to a change in estimates and reduced workers compensation expenses.

Assisted Living operating expenses increased \$60.9 million, or 10.1%, primarily due to the inclusion of expenses from acquisitions that occurred late in the fourth quarter of 2009, an increase in expenses incurred in connection with the continued expansion of our ancillary services programs, and increased salaries and wages due to wage

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rate increases and an increase in hours worked year over year. These increases were partially offset by reduced workers compensation expenses and a decrease in bad debt expense.

CCRCs operating expenses increased \$46.5 million, or 11.1%, primarily due to the inclusion of expenses from expansions that occurred late in the fourth quarter of 2009, increased salaries and wages due to wage rate increases and an increase in hours worked year over year, as well as increases in lighting retrofit costs related to an initiative to use more energy efficient lighting in our communities. These increases were partially offset by a decrease in insurance expense related to a change in estimates, reduced workers compensation expenses and a decrease in bad debt expense.

## General and Administrative Expense

General and administrative expense decreased \$3.2 million, or 2.3%, primarily as a result of a decrease in non-cash stock-based compensation expense in connection with restricted stock grants and transaction-related costs incurred in the prior year. These decreases were partially offset by increased travel and employee benefit expenses. General and administrative expense as a percentage of total revenue, including revenue generated by the communities we manage and excluding non-cash stock-based compensation expense and integration and transaction-related costs, was 4.7% for the years ended December 31, 2010 and 2009, calculated as follows (dollars in thousands):

	Year Ended December 31,							
	2010			2009				
Resident fee revenues	\$	2,207,673	94.1	%	\$	2,016,349	92.7	%
Resident fee revenues under management		139,478	5.9	%		157,618	7.3	%
Total	\$	2,347,151	100	%	\$	2,173,967	100	%
General and administrative expenses (excluding non-cash stock-based compensation expense and integration and transaction-related costs)	\$	110,950	4.7	%	\$	101,676	4.7	%
Non-cash stock-based compensation expense		20,759	0.9	%		26,935	1.2	%
Integration and transaction-related costs			0.0	%		6,253	0.3	%
General and administrative expenses (including non-cash stock-based compensation expense and integration and transaction-related costs)	\$	131,709	5.6	%	\$	134,864	6.2	%

## Facility Lease Expense

Facility lease expense remained relatively constant period over period.

## Depreciation and Amortization

Depreciation and amortization expense increased by \$20.4 million, or 7.5%, primarily due to the inclusion of acquisitions and expansions that occurred or opened later in the prior year.

#### Asset Impairment

During 2010 and 2009, we recognized \$13.1 million and \$10.1 million, respectively, of impairment charges related to asset impairments for property, plant and equipment and leasehold intangibles for certain communities within the Assisted Living and Retirement Centers segments. In both years, the non-cash impairment charges were primarily due to lower than expected performance of the underlying communities.

#### Costs Incurred on Behalf of Managed Communities

Costs incurred on behalf of managed communities decreased \$9.9 million, or 12.9%, primarily due to decreased occupancy at our managed communities year over year.

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### Interest Income

Interest income remained relatively constant period over period.

### Interest Expense

Interest expense increased \$11.1 million, or 8.3%, primarily due to additional interest expense recorded from the change in the fair value of interest rate swaps and caps due to changes in the LIBOR yield curve period over period. Additionally, interest expense on our mortgage debt increased due to the inclusion of acquisitions and expansions that occurred or opened since late 2009, partially offset by a decrease in interest expense related to our line of credit.

### Income Taxes

The reduction in the income tax benefit over the prior year is due to an increase in the effective tax rate from 33.2% in 2009 to 39.1% in 2010. This increase is primarily due to the impact of the nondeductible stock-based compensation recorded under ASC 718-10 which was treated as non-deductible expense in 2009.

### 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 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 non-refundable 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, adjusted annually. 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 related anticipated revenues including 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

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communities under a master insurance program, our current policy provides for deductibles for each and every claim (\$150,000 effective January 1, 2010). The amount of liquid assets separately available to satisfy these deductible obligations is \$17.3 million as of December 31, 2011 (classified as cash and escrow deposits – restricted in the consolidated balance sheets). As a result, we are effectively self-insured for claims that are less than \$150,000. In addition, we maintain a self-insured workers compensation program (with excess loss coverage generally above \$1.0 million effective January 1, 2010) 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 offices 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 estimated 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.

### Investment in Unconsolidated Ventures

ASC 810 – Consolidation of Variable Interest Entities, addresses the identification of variable interest entities (“VIE”) and consolidation by business enterprises deemed to be primary beneficiaries in the VIE. We identify the primary beneficiary of a VIE as the enterprise that has both of the following characteristics: (i) the power to direct the activities of the VIE that most significantly impact the entity’s economic performance; and (ii) the obligation to absorb losses or receive benefits of the VIE that could potentially be significant to the entity. We perform this analysis on an ongoing basis. At December 31, 2011, we did not have any unconsolidated VIEs. Investments in affiliated companies that we do not control, but have the ability to exercise significant influence over governance and operation, are accounted for by the equity method.

For ventures not consolidated, we apply the equity method of accounting in accordance with ASC Investments — Equity Method and Joint Ventures Topic. Equity method investments are initially recorded at cost and subsequently are adjusted for our share of the venture’s earnings or losses and cash distributions. In accordance with this guidance, the allocation of profit and losses should be analyzed to determine how an increase or decrease in net assets of the venture (determined in conformity with GAAP) will affect cash payments to the investor over the life of the venture and on its liquidation. Because certain venture agreements contain preferences with regard to cash flows from operations, capital

events and/or liquidation, we reflect our share of profits and losses by determining the difference between our “claim on the investee’s book value” at the end and the beginning of the period. This claim is calculated as the amount that we would receive (or be obligated to pay) if the investee were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to creditors and investors in accordance with their respective priorities. This method is commonly referred to as the hypothetical liquidation at book value method.

Our reported share of earnings is adjusted for the impact, if any, of basis differences between our carrying value of the equity investment and our share of the venture’s underlying assets. We generally do not have future requirements to contribute additional capital over and above the original capital commitments, and therefore, we discontinue applying the equity method of accounting when our investment is reduced to zero barring an



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expectation of an imminent return to profitability. If the venture subsequently reports net income, the equity method of accounting is resumed only after our share of that net income equals the share of net losses not recognized during the period the equity method was suspended.

When the majority equity partner in one of our ventures sells its equity interest to a third party, the venture frequently refinances its senior debt and distributes the net proceeds to the equity partners. All distributions received by us are first recorded as a reduction of our investment. Next, we record a liability for any contractual or implied future financial support to the venture including obligations in our role as a general partner. Any remaining distributions are recorded as our share of earnings and return on investment in unconsolidated ventures in the consolidated statements of operations.

We evaluate realization of our investment in ventures accounted for using the equity method if circumstances indicate that our investment is other than temporarily impaired.

## Income Taxes

We account for income taxes under the provisions of ASC 740 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 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, 2011 and 2010, we have a valuation allowance against deferred tax assets of approximately \$40.8 million and \$10.8 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 income. This determination will be made by considering various factors, including the reversal of existing temporary differences, tax planning strategies and estimates of future taxable income exclusive of the reversal of temporary differences.

We have elected the “with-and-without approach” regarding ordering of windfall tax benefits to determine whether the windfall tax benefit did reduce taxes payable in the current year. Under this approach, the windfall tax benefits would be recognized in additional paid-in capital only if an incremental tax benefit is realized after considering all other tax benefits presently available to us.

## 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, 2011, we operated 350 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.

For leases in which we are involved with the construction of the building, we account for the lease during the construction period under the provisions of ASC 840. If we conclude that we have substantively all of the risks

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of ownership during construction of a leased property and therefore we are deemed the owner of the project for accounting purposes, we record an asset and related financing obligation for the amount of total project costs related to construction in progress and the pre-existing asset. Once construction is complete, we consider the requirements under ASC 840-40 – Leases – Sale-Leaseback Transactions. If the arrangement does not qualify for sale-leaseback accounting, we continue to amortize the financing obligation and depreciate the building over the lease term.

### Allowance for Doubtful Accounts and Contractual Adjustments

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 \$17.0 million and \$14.5 million as of December 31, 2011 and 2010, 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. Recent changes in legislation are not expected to have a material impact on the collectability of our accounts receivable; however, changes in economic conditions could have an impact on the collection of existing receivable balances or future allowance calculations.

Approximately 79.5% and 80.6% of our resident and healthcare revenues for the years ended December 31, 2011 and 2010, respectively, were derived from private pay customers and 20.5% and 19.4% of our resident and healthcare revenues for the years ended December 31, 2011 and 2010, respectively, were derived from 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. Revenue related to these billings is recorded 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, 2011 and 2010, our long-lived assets were comprised primarily of \$3.7 billion of property, plant and equipment and leasehold intangibles. In accounting for our long-lived assets, other than goodwill, we apply the provisions of ASC 360 Property, Plant and Equipment. 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 respective reporting unit and included in our application of the provisions of ASC 350 Intangibles – Goodwill and Other (“ASC 350”). We account for goodwill under the provisions of ASC 350. As of December 31, 2011 and 2010, we had \$109.6 million and \$109.7 million of goodwill, respectively.

We test long-lived assets other than goodwill and indefinite-lived intangible assets 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. During the years ended December 31, 2011 and 2010, we evaluated

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 a small number of communities. Estimated fair values were determined and non-cash asset impairment charges of \$16.9 million and \$13.1 million were taken for the years ended December 31, 2011 and 2010, respectively, for six communities in each period within the Retirement Centers and Assisted Living segments.

Goodwill is not amortized, but is subject to annual or more frequent impairment testing. We test goodwill for

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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.

Indefinite-lived intangible assets are tested for impairment annually during our fourth quarter or more frequently as required. The impairment test consists of a comparison of the estimated fair value of the indefinite-lived intangible asset with its carrying value. If the carrying amount exceeds its fair value, an impairment loss is recognized for that difference.

In estimating the fair value of long-lived assets (groups) and reporting units for purposes of our goodwill impairment test, we generally 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 the fair value of long-lived assets (groups) and reporting units for purposes of our goodwill impairment test, we make certain key assumptions. Those assumptions include future revenues and future facility operating expenses, and future cash flows that we would receive upon a sale of the communities using estimated capitalization rates. We corroborate the capitalization rates we use in these calculations with capitalization 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 from a market participant perspective. 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.

## 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.

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.

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## Stock-Based Compensation

We adopted ASC 718 Compensation – Stock Compensation ("ASC 718") 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. ASC 718 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. ASC 718 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. As described in Note 23 to the consolidated financial statements, 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 and healthcare industries. 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".

## 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,	
	2011	2010
Cash provided by operating activities	\$ 268,427	\$ 228,244
Cash used in investing activities	(203,899 )	(136,505 )
Cash used in financing activities	(115,519 )	(76,282 )
Net (decrease) increase in cash and cash equivalents	(50,991 )	15,457
Cash and cash equivalents at beginning of year	81,827	66,370
Cash and cash equivalents at end of year	\$ 30,836	\$ 81,827

The increase in cash provided by operating activities was attributable primarily to increased cash provided by changes in working capital and, to a lesser extent, improved operating results.

The increase in cash used in investing activities was primarily attributable to an increase in spending on property, plant, equipment and leasehold intangibles and cash paid for acquisitions. In the current year, we also invested cash to gain a non-controlling interest in a joint venture. The increase was partially offset by an increase in cash received from the proceeds from the sale of assets as well as a decrease in cash related to the release of escrow on a recently opened entrance fee CCRC. The escrowed funds were used to repay debt outstanding on the community.



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The increase in cash used in financing activities was primarily attributable to an increase in net repayments of debt year over year including the repayment of debt on a recently opened CCRC when entrance fees originally escrowed were released in accordance with state regulations as well as repayments of debt from proceeds received in connection with the convertible debt offering in June 2011. Additionally, there was an increase in the cash portion of the loss on extinguishment of debt in the current year and we repurchased 1,217,100 shares of our common stock at an aggregate cost of \$17.6 million. The increase was partially offset by net cash received from the current year convertible debt offering.

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 and/or non-core assets.

Over the longer-term, we expect to continue to fund our business through these principal sources of liquidity.

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;
- 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 share repurchase authorizations; 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, redevelopment and repositioning of our current communities and the development of new communities;
- other corporate initiatives (including information systems);
- acquisition consideration and transaction costs;
- purchases of common stock under our share repurchase authorization; 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. As of December 31, 2011, we have three principal corporate-level debt obligations: our \$230.0 million revolving credit facility, our \$316.3 million convertible senior notes due 2018 and separate secured and unsecured letter of credit facilities providing for up to \$85.7 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, 2011, we had \$2.1 billion of debt outstanding, excluding capital lease obligations and our line of credit, at a weighted-average interest rate of 4.78% (calculated using an imputed interest rate of 7.5% for our

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\$316.3 million convertible senior notes due 2018). At December 31, 2011, we had \$348.2 million of capital and financing lease obligations, \$65.0 million was drawn on our revolving loan facility, and \$78.1 million of letters of credit had been issued under our letter of credit facilities. Approximately \$47.7 million of our debt and capital lease obligations are due on or before December 31, 2012. We also have substantial operating lease obligations and capital expenditure requirements. For the year ending December 31, 2012, we will be required to make approximately \$284.5 million of payments in connection with our existing operating leases.

We had \$30.8 million of cash and cash equivalents at December 31, 2011, excluding cash and escrow deposits-restricted, marketable securities-restricted and lease security deposits of \$167.4 million in the aggregate. As of that date, we also had \$194.2 million of availability on our revolving credit facility (of which \$65.0 million had been drawn as of December 31, 2011).

At December 31, 2011, we had \$340.1 million of negative working capital, which includes the classification of \$242.6 million of refundable entrance fees and \$7.7 million in tenant deposits 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 \$42.2 million of cash for the year ended December 31, 2011. This includes \$12.6 million of first generation entrance fee receipts which represent initial entrance fees received from the sale of units at a recently opened entrance fee CCRC.

For the year ending December 31, 2012, we anticipate that we will make investments of approximately \$135.0 million to \$145.0 million for net capital expenditures (excluding expenditures related to our Program Max initiative discussed below), comprised of approximately \$40.0 million to \$45.0 million of net recurring capital expenditures and approximately \$95.0 million to \$100.0 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, integration related expenditures (including the cost of developing information systems), and expenditures supporting the expansion of our ancillary services programs. For the year ended December 31, 2011, we spent approximately \$33.7 million for net recurring capital expenditures and approximately \$80.1 million for expenditures relating to other major projects and corporate initiatives.

In addition, during 2011, we have increased our efforts with respect to the expansion, redevelopment and repositioning of our communities through our Program Max initiative. We anticipate making net investments of approximately \$60.0 million to \$70.0 million over the next 12 months in connection with recently initiated or currently planned projects. For the year ended December 31, 2011, we spent approximately \$39.6 million in connection with our Program Max initiative.

During 2012, we anticipate that our capital expenditures will be funded from cash on hand, cash flows from operations, lessor reimbursement and amounts drawn on our credit facility.

As opportunities arise, we plan to continue to take advantage of the fragmented senior housing and care sectors by selectively purchasing existing operating companies, asset portfolios, home health agencies and communities. We may also seek to acquire the fee interest in communities that we currently lease or manage.

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. We have taken a number of steps to reduce our collateral posting risk. In particular, we terminated a number of interest rate swaps and purchased and assumed a number of interest rate caps, which do not require the posting of cash collateral. Furthermore, we obtained a number of swaps that were secured by underlying mortgaged assets and, hence, did not require cash collateralization. As of December 31, 2011, we have \$248.8 million in aggregate notional amount of interest rate caps, a \$27.8 million notional amount swap that does not require cash collateralization and a \$150.0 million notional amount swap that does require cash collateralization. \$216.9 million of our variable rate debt, excluding our secured line of credit and capital lease obligations, is not subject to any cap or swap agreements.

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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.

We currently estimate that our existing cash flows from operations, together with existing working capital, amounts available under our credit facility and, to a lesser extent, proceeds from anticipated financings and 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.

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, 2011, we are in compliance with the financial covenants of our outstanding debt and lease agreements.

### Credit Facilities

#### 2010 Credit Facility

Effective February 23, 2010, we entered into a credit agreement with General Electric Capital Corporation, as administrative agent and lender, and the other lenders from time to time parties thereto. The facility had an initial commitment of \$100.0 million, with an option to increase the commitment to \$120.0 million (which we exercised on May 5, 2010), and was scheduled to mature on June 30, 2013.

The revolving line of credit could be used to finance acquisitions and fund working capital and capital expenditures and for other general corporate purposes.

The facility was secured by a first priority lien on certain of our communities. The availability under the line could vary from time to time as it was based on borrowing base calculations related to the value and performance of the communities securing the facility.

Amounts drawn under the facility bore interest at 90-day LIBOR plus an applicable margin, as described below. For purposes of determining the interest rate, in no event would LIBOR be less than 2.0%. The applicable margin varied with the percentage of the total commitment drawn, with a 4.5% margin at 35% or lower utilization, a 5.0% margin at utilization greater than 35% but less than or equal to 50%, and a 5.5% margin at greater than 50% utilization. We

were also required to pay a quarterly commitment fee of 1.0% per annum on the unused portion of the facility.

The credit agreement contained typical affirmative and negative covenants, including financial covenants with respect to minimum consolidated fixed charge coverage and minimum consolidated tangible net worth. A violation of any of these covenants could have resulted in a default under the credit agreement, which would have resulted in termination of all commitments under the credit agreement and all amounts owing under the credit agreement and certain other loan agreements becoming immediately due and payable.

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### 2011 Credit Facility

On January 31, 2011, we entered into an amended and restated credit agreement with General Electric Capital Corporation, as administrative agent and lender, and the other lenders from time to time parties thereto. The amended credit agreement amended and restated in its entirety our existing credit agreement dated as of February 23, 2010, as previously amended. The amended credit agreement increased the commitment under the credit facility from \$120.0 million to \$200.0 million and extended the maturity date to January 31, 2016. Other than the expansion of the commitment and the extension of the maturity date, no other material terms of the previous credit agreement (as described above) were amended. Effective February 23, 2011, the commitment under the amended and restated credit agreement was further increased to \$230.0 million.

As of December 31, 2011, we had an available secured line of credit with a \$230.0 million commitment and \$194.2 million of availability (of which \$65.0 million had been drawn as of such date). We also had secured and unsecured letter of credit facilities of up to \$85.7 million in the aggregate as of December 31, 2011. \$78.1 million of letters of credit had been issued under these facilities as of such date.

### Convertible Debt Offering

In June 2011, we completed a registered offering of \$316.3 million aggregate principal amount of 2.75% convertible senior notes (the "Notes"). We received net proceeds of approximately \$308.2 million after the deduction of underwriting commissions and offering expenses. We used a portion of the net proceeds to pay our cost of the convertible note hedge transactions described below, taking into account our proceeds from the warrant transactions described below, and used the balance of the net proceeds to repay existing outstanding debt. The Notes are senior unsecured obligations and rank equally in right of payment to all of our other senior unsecured debt, if any. The Notes will be senior in right of payment to any of our debt which is subordinated by its terms to the Notes (if any). The Notes are also structurally subordinated to all debt and other liabilities and commitments (including trade payables) of our subsidiaries. The Notes are also effectively subordinated to our secured debt to the extent of the assets securing such debt.

The Notes bear interest at 2.75% per annum, payable semi-annually in cash. The Notes are convertible at an initial conversion rate of 34.1006 shares of our common stock per \$1,000 principal amount of Notes (equivalent to an initial conversion price of approximately \$29.325 per share), subject to adjustment. Holders may convert their Notes at their option prior to the close of business on the second trading day immediately preceding the stated maturity date only under the following circumstances: (i) during any fiscal quarter commencing after the fiscal quarter ending September 30, 2011, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (ii) during the five business day period after any five consecutive trading day period (the "measurement period"), in which the trading price per \$1,000 principal amount of notes for each trading day of that measurement period was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on each such day; or (iii) upon the occurrence of specified corporate events. On and after March 15, 2018, until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their Notes at any time, regardless of the foregoing circumstances. Unconverted Notes mature at par in June 2018.

Upon conversion, we will satisfy our conversion obligation by paying or delivering, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock at our election. It is our current intent and policy to settle the principal amount of the Notes (or, if less, the amount of the conversion obligation) in cash upon conversion.

In addition, following certain corporate transactions, we will increase the conversion rate for a holder who elects to convert in connection with such transaction by a number of additional shares of common stock as set forth in the supplemental indenture governing the Notes.

In connection with the offering of the Notes, in June 2011, we entered into convertible note hedge transactions (the "Convertible Note Hedges") with certain financial institutions (the "Hedge Counterparties"). The Convertible Note Hedges cover, subject to customary anti-dilution adjustments, 10,784,315 shares of common





(2) Reflects future cash payments after giving effect to non-contingent lease escalators and assumes payments on variable rate instruments at the December 31, 2011 rate.

(3) 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 \$78.1 million as of December 31, 2011.

#### Company Indebtedness, Long-term Leases and Hedging Agreements

##### Indebtedness

As of December 31, 2011, we have three principal corporate-level debt obligations: our \$230.0 million revolving credit facility, our \$316.3 million convertible senior notes due 2018 and separate secured and unsecured letter of credit facilities providing for up to \$85.7 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, 2011 and 2010, our outstanding property-level secured debt and capital leases were \$2.2 billion and \$2.6 billion, respectively.

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During 2011, we incurred \$482.7 million of property-level debt primarily related to the financing of acquisitions, the expansion of certain communities, the refinancing of existing debt and the releveraging of certain assets. Approximately \$149.6 million of the new debt was issued at a variable interest rate and the remaining \$333.1 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 self-insured retention risk under workers' compensation and general liability and professional liability programs with cash aggregating \$17.3 million and \$18.0 million as of December 31, 2011 and 2010, respectively, and letters of credit aggregating \$40.7 million and \$33.7 million as of December 31, 2011 and 2010, respectively.

As of December 31, 2011, we are in compliance with the financial covenants of our outstanding debt, including those covenants measuring facility operating income to gauge debt coverage.

### Long-Term Leases

As of December 31, 2011, we have 350 communities operated 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 \$80.0 million of variable rate mortgages and/or tax exempt debt that is credit enhanced by Freddie Mac.

For the year ended December 31, 2011, our minimum annual cash lease payments for our capital/financing leases and operating leases were \$54.5 million and \$268.6 million, respectively.

As of December 31, 2011, 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 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. We have taken a number of steps to reduce our collateral posting risk. As of December 31, 2011, we have \$248.8 million in aggregate notional amount of interest rate caps, \$177.8 million in aggregate notional amount of swaps (of which \$150.0 million requires cash collateralization) and \$216.9 million of variable rate debt, excluding our secured line of credit and capital lease obligations, 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 the Company's swap instruments at December 31, 2011 (dollars in thousands):

Current notional balance	\$177,756	
Highest possible notional	\$177,756	
Lowest interest rate	0.87	%
Highest interest rate	5.49	%
Average fixed rate	1.59	%
Earliest maturity date	2013	

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Latest maturity date		2016
Weighted average original maturity		3.2 years
Estimated liability fair value (included in other liabilities at December 31, 2011)	\$	(2,809 )
Estimated asset fair value (included in other assets at December 31, 2010)	\$	281

The following table summarizes the Company's cap instruments at December 31, 2011 (dollars in thousands):

Current notional balance	\$	248,768	
Highest possible notional	\$	248,768	
Lowest interest cap rate		5.50	%
Highest interest cap rate		6.00	%
Average fixed cap rate		5.74	%
Earliest maturity date		2012	
Latest maturity date		2013	
Weighted average original maturity		2.6 years	
Estimated asset fair value (included in other liabilities at December 31, 2011)	\$	—	
Estimated asset fair value (included in other assets at December 31, 2010)	\$	157	

## 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 communities. 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, 2011, approximately \$636.8 million 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.

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Adjusted EBITDA

Definition of Adjusted EBITDA

We define Adjusted EBITDA as follows:

Net income (loss) before:

- provision (benefit) for income taxes;
- non-operating (income) expense items;
- (gain) loss on sale or acquisition of communities (including facility lease termination expense);
- depreciation and amortization (including non-cash impairment charges);
- straight-line lease expense (income);
- amortization of deferred gain;
- amortization of deferred entrance fees;
- non-cash stock-based compensation expense; and
- change in future service obligation;

and including:

- entrance fee receipts and refunds (excluding first generation entrance fee receipts from the sale of units at a recently opened entrance fee CCRC and first generation entrance fee refunds not replaced by second generation entrance fee receipts at the recently opened community).

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 the change in the liability for the obligation to provide future services under existing lifecare contracts, depreciation and amortization (including non-cash impairment charges), straight-line lease 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:



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- 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 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, 2011, 2010 and 2009 (dollars in thousands):

	Years Ended December 31(1),		
	2011	2010	2009
Net loss	\$ (68,175 )	\$ (48,901 )	\$ (66,255 )
Provision (benefit) for income taxes	2,340	(31,432 )	(32,926 )
Other non-operating (income) expense	(56 )	1,454	(4,146 )
Equity in earnings of unconsolidated ventures	(1,432 )	(168 )	(440 )
Loss on extinguishment of debt, net	18,863	1,557	1,292
Interest expense:			
Debt	93,229	102,245	99,653
Capitalized lease obligation	31,644	30,396	29,216
Amortization of deferred financing costs and debt discount	13,427	8,963	9,505
Change in fair value of derivatives and amortization	3,878	4,118	(3,765 )
Interest income	(3,538 )	(2,238 )	(2,354 )
Income from operations	90,180	65,994	29,780
Facility lease termination expense	—	4,608	
(Gain) loss on sale of communities, net	—	(3,298 )	2,043
Gain on acquisition	(1,982 )	—	—
Depreciation and amortization	268,506	292,341	271,935
Asset impairment	16,892	13,075	10,073
Straight-line lease expense	8,608	10,521	15,851
Amortization of deferred gain	(4,373 )	(4,343 )	(4,345 )
Amortization of entrance fees	(25,401 )	(24,397 )	(21,661 )

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Non-cash stock-based compensation expense	19,856	20,759	26,935
Change in future service obligation	—	(1,064 )	(2,342 )
Entrance fee receipts(2)	67,989	73,906	68,875
First generation entrance fees received(3)	(12,617 )	(18,548 )	(25,673 )
Entrance fee disbursements(4)	(24,993 )	(21,060 )	(22,916 )
Adjusted EBITDA	\$ 402,665	\$ 408,494	\$ 348,555

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- (1) The calculation of Adjusted EBITDA includes integration and transaction-related costs of \$14.4 million and \$6.3 million for the years ended December 31, 2011 and 2009, respectively. There were no such costs in 2010.
- (2) Includes the receipt of refundable and non-refundable entrance fees.
- (3) First generation entrance fees received represents initial entrance fees received from the sale of units at a recently opened entrance fee CCRC.
- (4) Entrance fee refunds disbursed excludes \$0.8 million of first generation entrance fee refunds not replaced by second generation entrance fee receipts at the recently opened community for the year ended December 31, 2011.

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:

- changes in operating assets and liabilities;
- deferred interest and fees added to principal;
- refundable entrance fees received;
- first generation entrance fee receipts at a recently opened entrance fee CCRC;
- entrance fee refunds disbursed adjusted for first generation entrance fee refunds not replaced by second generation entrance fee receipts at the recently opened community;
- lease financing debt amortization with fair market value or no purchase options;
  - facility lease termination expense;
  - recurring capital expenditures, net;
- distributions from unconsolidated ventures from cumulative share of net earnings;
  - CFFO from unconsolidated ventures; and
  - other.

Recurring capital expenditures include routine expenditures capitalized in accordance with GAAP that are funded from current operations. Amounts excluded from recurring capital expenditures consist primarily of major projects, renovations, community repositionings, expansions, systems projects or other non-recurring or unusual capital items (including integration capital expenditures) or community purchases that are funded using lease or financing proceeds, available cash and/or proceeds from the sale of communities that are held for sale.

In the fourth quarter of 2010, we revised the definition of Cash From Facility Operations to exclude distributions from unconsolidated ventures from cumulative share of net earnings and include our proportionate share (based on equity ownership percentages) of the Cash From Facility Operations generated by our unconsolidated ventures. This impact

is included in the Cash From Facility Operations for the years ended December 31, 2011 and 2010. Due to immateriality, the year ended December 31, 2009 has not been restated.

#### 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.

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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) to review our ability to pay dividends to stockholders, (iii) to review 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, (v) in making compensation determinations for certain of our associates (including our named executive officers) and (vi) 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 per year. Historically, we have spent in excess of these per unit amounts; however, there is no assurance that we will have funds available to escrow or spend these per unit 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.

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, 2011, 2010 and 2009 (dollars in thousands):

	Years Ended December 31(1),		
	2011	2010	2009
Net cash provided by operating activities	\$ 268,427	\$ 228,244	\$ 237,220

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Changes in operating assets and liabilities	20,914	46,674	4,532
Refundable entrance fees received (2)(3)	29,611	36,420	30,386
First generation entrance fees received(4)	(12,617 )	(18,548 )	(25,673 )
Entrance fee refunds disbursed(5)	(24,993 )	(21,060 )	(22,916 )
Recurring capital expenditures, net	(33,661 )	(27,969 )	(19,522 )
Lease financing debt amortization with fair market value or no purchase options	(10,465 )	(8,972 )	(7,195 )

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Facility lease termination expense	—	4,608	
Distributions from unconsolidated ventures from cumulative share of net earnings	(582 )	(775 )	
CFFO from unconsolidated ventures	3,289	2,050	
Cash From Facility Operations	\$239,923	\$240,672	\$196,832

- (1) The calculation of Cash From Facility Operations includes integration and transaction-related costs of \$14.4 million and \$6.3 million for the years ended December 31, 2011 and 2009, respectively. There were no such costs in 2010.
- (2) Entrance fee receipts include promissory notes issued to the Company by the resident in lieu of a portion of the entrance fees due. Notes issued (net of collections) for the years ended December 31, 2011, 2010 and 2009 were \$3.3 million, \$1.7 million and \$9.3 million, respectively.
- (3) Total entrance fee receipts for the year ended December 31, 2011, 2010 and 2009 were \$68.0 million, \$73.9 million, and \$68.9 million, respectively, including \$38.4 million, \$37.5 million and \$38.5 million, respectively, of non-refundable entrance fee receipts included in net cash provided by operating activities.
- (4) First generation entrance fees received represents initial entrance fees received from the sale of units at a recently opened entrance fee CCRC.
- (5) Entrance fee refunds disbursed excludes \$0.8 million of first generation entrance fee refunds not replaced by second generation entrance fee receipts at the recently opened community for the year ended December 31, 2011.

## 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) expense items;
- (gain) loss on sale or acquisition of communities (including facility lease termination expense);
- depreciation and amortization (including non-cash impairment charges);
  - facility lease expense;
- general and administrative expense, including non-cash stock-based compensation expense;
  - change in future service obligation;
- 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



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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 the change in the liability for the obligation to provide future services under existing lifecare contracts, depreciation and amortization (including non-cash impairment charges), straight-line lease expense (income), 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 community.

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). 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 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.

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The table below shows the reconciliation of net loss to Facility Operating Income for the years ended December 31, 2011, 2010 and 2009 (dollars in thousands):

	Years Ended December 31,		
	2011	2010	2009
Net loss	\$ (68,175 )	\$ (48,901 )	\$ (66,255 )
Provision (benefit) for income taxes	2,340	(31,432 )	(32,926 )
Other non-operating (income) expense	(56 )	1,454	(4,146 )
Equity in earnings of unconsolidated ventures	(1,432 )	(168 )	(440 )
Loss on extinguishment of debt, net	18,863	1,557	1,292
Interest expense:			
Debt	93,229	102,245	99,653
Capitalized lease obligation	31,644	30,396	29,216
Amortization of deferred financing costs and debt discount	13,427	8,963	9,505
Change in fair value of derivatives and amortization	3,878	4,118	(3,765 )
Interest income	(3,538 )	(2,238 )	(2,354 )
Income from operations	90,180	65,994	29,780
Facility lease termination expense	—	4,608	
(Gain) loss on sale of communities, net	—	(3,298 )	2,043
Depreciation and amortization	268,506	292,341	271,935
Asset impairment	16,892	13,075	10,073
Gain on acquisition	(1,982 )	—	—
Facility lease expense	274,858	270,905	272,096
General and administrative (including non-cash stock-based compensation expense)	148,327	131,709	134,864
Change in future service obligation	—	(1,064 )	(2,342 )
Amortization of entrance fees	(25,401 )	(24,397 )	(21,661 )
Management fees	(13,595 )	(5,591 )	(6,719 )
Facility Operating Income	\$ 757,785	\$ 744,282	\$ 690,069

## 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, 2011, we had approximately \$1.4 billion of long-term fixed rate debt, \$0.6 billion of long-term variable rate debt and \$348.2 million of capital and financing lease obligations. As of December 31, 2011, our total fixed-rate debt and variable-rate debt outstanding had a weighted-average interest rate of 4.78% (calculated using an imputed interest rate of 7.50% for our \$316.3 million convertible senior notes due 2018).

We enter into certain interest rate swap agreements with major financial institutions to manage our risk on variable rate debt. Additionally, we have entered into certain cap agreements to effectively manage our risk above certain interest rates. As of December 31, 2011, \$1.6 billion, or 77.5%, 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, 2011, \$243.5 million, or 11.9%, of our debt, excluding our line of credit and capital and financing lease obligations, is subject to cap agreements. The remaining \$216.9 million, or 10.6%, 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 \$3.7 million, \$21.5 million and \$33.8 million, respectively.

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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.

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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. (the “Company”) as of December 31, 2011 and 2010, and the related consolidated statements of operations, equity and cash flows for each of the three years in the period ended December 31, 2011. 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, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, 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, 2011, 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 28, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois  
28 February 2012

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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, 2011, 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, 2011, 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, 2011 and 2010 and the related consolidated statements of operations, equity, and cash flows for each of the three years in the period ended December 31, 2011, and our report dated February 28, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP



Chicago, Illinois  
28 February 2012

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

	December 31,	
	2011	2010
Assets		
Current assets		
Cash and cash equivalents	\$ 30,836	\$ 81,827
Cash and escrow deposits – restricted	45,903	79,669
Accounts receivable, net	98,697	88,033
Deferred tax asset	11,776	15,529
Prepaid expenses and other current assets, net	93,663	63,051
Total current assets	280,875	328,109
Property, plant and equipment and leasehold intangibles, net	3,694,064	3,736,842
Cash and escrow deposits – restricted	52,980	65,316
Marketable securities — restricted	31,721	—
Investment in unconsolidated ventures	32,798	20,196
Goodwill	109,553	109,693
Other intangible assets, net	154,136	171,341
Other assets, net	109,934	98,973
Total assets	\$ 4,466,061	\$ 4,530,470
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 47,654	\$ 71,676
Trade accounts payable	54,134	36,302
Accrued expenses	183,634	171,537
Refundable entrance fees and deferred revenue	327,808	318,814
Tenant security deposits	7,720	8,029
Total current liabilities	620,950	606,358
Long-term debt, less current portion	2,350,971	2,498,620
Line of credit	65,000	—
Deferred entrance fee revenue	72,485	69,075
Deferred liabilities	161,185	153,199
Deferred tax liability	112,736	113,956
Other liabilities	42,526	29,265
Total liabilities	3,425,853	3,470,473
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized at December 31, 2011 and 2010; no shares issued and outstanding	—	—
Common stock, \$0.01 par value, 200,000,000 shares authorized at December 31, 2011 and 2010; 127,782,538 and 125,527,846 shares issued and 125,354,137 and 124,316,545 shares outstanding (including 4,221,598 and 3,539,751 unvested restricted shares), respectively	1,254	1,243
Additional paid-in-capital	1,970,820	1,904,144

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Treasury stock, at cost; 2,428,401 and 1,211,301 shares at December 31, 2011 and 2010, respectively	(46,800 )	(29,187 )
Accumulated deficit	(884,051 )	(815,876 )
Accumulated other comprehensive loss	(1,015 )	(327 )
Total stockholders' equity	1,040,208	1,059,997
Total liabilities and stockholders' equity	\$ 4,466,061	\$ 4,530,470

See accompanying notes to consolidated financial statements.

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BROOKDALE SENIOR LIVING INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share data)

	For the Years Ended		
	2011	December 31, 2010	2009
Revenue			
Resident fees	\$ 2,291,757	\$ 2,207,673	\$ 2,016,349
Management fees	13,595	5,591	6,719
Reimbursed costs incurred on behalf of managed communities	152,566	67,271	77,206
Total revenue	2,457,918	2,280,535	2,100,274
Expense			
Facility operating expense (excluding depreciation and amortization of \$211,038, \$208,181 and \$184,780, respectively)	1,508,571	1,437,930	1,302,277
General and administrative expense (including non-cash stock-based compensation expense of \$19,856, \$20,759 and \$26,935, respectively)	148,327	131,709	134,864
Facility lease expense	274,858	270,905	272,096
Depreciation and amortization	268,506	292,341	271,935
(Gain) loss on sale of communities, net	—	(3,298 )	2,043
Asset impairment	16,892	13,075	10,073
Gain on acquisition	(1,982 )	—	—
Costs incurred on behalf of managed communities	152,566	67,271	77,206
Facility lease termination expense	—	4,608	—
Total operating expense	2,367,738	2,214,541	2,070,494
Income from operations	90,180	65,994	29,780
Interest income	3,538	2,238	2,354
Interest expense:			
Debt	(124,873 )	(132,641 )	(128,869 )
Amortization of deferred financing costs and debt discount	(13,427 )	(8,963 )	(9,505 )
Change in fair value of derivatives and amortization	(3,878 )	(4,118 )	3,765
Loss on extinguishment of debt, net	(18,863 )	(1,557 )	(1,292 )
Equity in earnings of unconsolidated ventures	1,432	168	440
Other non-operating income (expense)	56	(1,454 )	4,146
Loss before income taxes	(65,835 )	(80,333 )	(99,181 )
(Provision) benefit for income taxes	(2,340 )	31,432	32,926
Net loss	\$ (68,175 )	\$ (48,901 )	\$ (66,255 )
Basic and diluted net loss per share	\$ (0.56 )	\$ (0.41 )	\$ (0.60 )
Weighted average shares used in computing basic and diluted net loss per share	121,161	120,010	111,288

See accompanying notes to consolidated financial statements.

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BROOKDALE SENIOR LIVING INC.  
CONSOLIDATED STATEMENTS OF EQUITY  
For the Years Ended December 31, 2011, 2010 and 2009  
(In thousands)

	Common Stock			Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
	Shares	Amount	Additional Paid-In-Capital				
Balances at January 1, 2009	105,256	\$ 1,053	\$ 1,690,851	\$ (29,187)	\$ (700,720)	\$ (1,396 )	\$ 960,601
Compensation expense related to restricted stock grants	—	—	26,935	—	—	—	26,935
Net loss	—	—	—	—	(66,255 )	—	(66,255 )
Issuance of common stock under Associate Stock Purchase Plan	109	1	1,006	—	—	—	1,007
Restricted stock, net	1,794	18	(18 )	—	—	—	—
Reclassification of net gains on derivatives into earnings	—	—	—	—	—	493	493
Amortization of payments from settlement of forward interest rate swaps	—	—	—	—	—	376	376
Issuance of common stock from equity offering, net	16,047	160	163,611	—	—	—	163,771
Other	—	—	(8 )	—	—	(338 )	(346 )
Balances at December 31, 2009	123,206	1,232	1,882,377	(29,187)	(766,975)	(865 )	1,086,582
Compensation expense related to restricted stock grants	—	—	20,759	—	—	—	20,759
Net loss	—	—	—	—	(48,901 )	—	(48,901 )
Issuance of common stock under Associate Stock Purchase Plan	63	1	1,019	—	—	—	1,020
Restricted stock, net	1,048	10	(10 )	—	—	—	—
Reclassification of net gains on derivatives into earnings	—	—	—	—	—	505	505
Amortization of payments from settlement of forward interest rate swaps	—	—	—	—	—	376	376

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Other	—	—	(1 )	—	—	(343 )	(344 )
Balances at December 31, 2010	124,317	1,243	1,904,144	(29,187)	(815,876)	(327 )	1,059,997
Compensation expense related to restricted stock grants	—	—	19,856	—	—	—	19,856
Net loss	—	—	—	—	(68,175 )	—	(68,175 )
Common stock issued in connection with an acquisition	97	1	1,537	—	—	—	1,538
Equity component of convertible notes, net	—	—	76,801	—	—	—	76,801
Purchase of bond hedge	—	—	(77,007 )	—	—	—	(77,007 )
Issuance of warrants	—	—	45,066	—	—	—	45,066
Issuance of common stock under Associate Stock Purchase Plan	68	—	1,258	—	—	—	1,258
Restricted stock, net	2,089	10	(10 )	—	—	—	—
Unrealized loss on marketable securities - restricted	—	—	—	—	—	(998 )	(998 )
Reclassification of net gains on derivatives into earnings	—	—	—	—	—	134	134
Purchase of treasury stock	(1,217 )	—	—	(17,613)	—	—	(17,613 )
Amortization of payments from settlement of forward interest rate swaps	—	—	—	—	—	376	376
Other	—	—	(825 )	—	—	(200 )	(1,025 )
Balances at December 31, 2011	125,354	\$ 1,254	\$ 1,970,820	\$ (46,800)	\$ (884,051)	\$ (1,015 )	\$ 1,040,208

See accompanying notes to consolidated financial statements.

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BROOKDALE SENIOR LIVING INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

	For the Years Ended December 31,		
	2011	2010	2009
<b>Cash Flows from Operating Activities</b>			
Net loss	\$ (68,175 )	\$ (48,901 )	\$ (66,255 )
Adjustments to reconcile net loss to net cash provided by operating activities:			
Loss on extinguishment of debt	18,863	1,557	1,292
Depreciation and amortization	281,933	301,304	281,440
Asset impairment	16,892	13,075	10,073
Gain on sale of assets and unconsolidated ventures	(1,180 )	(2,509 )	(2,241 )
Equity in earnings of unconsolidated ventures	(1,432 )	(168 )	(440 )
Distributions from unconsolidated ventures from cumulative share of net earnings	1,282	775	405
Amortization of deferred gain	(4,373 )	(4,343 )	(4,345 )
Amortization of entrance fees	(25,401 )	(24,397 )	(21,661 )
Proceeds from deferred entrance fee revenue	38,378	37,486	38,489
Deferred income tax provision (benefit)	943	(33,295 )	(31,684 )
Change in deferred lease liability	8,608	10,521	15,851
Change in fair value of derivatives and amortization	3,878	4,118	(3,765 )
Gain on acquisition	(1,982 )		
Lessor cash reimbursement for tenant incentive	1,251	—	—
Change in future service obligation	—	(1,064 )	(2,342 )
Non-cash stock-based compensation	19,856	20,759	26,935
<b>Changes in operating assets and liabilities:</b>			
Accounts receivable, net	(5,367 )	(7,956 )	11,784
Prepaid expenses and other assets, net	(22,934 )	(22,050 )	(28,426 )
Accounts payable and accrued expenses	13,721	(11,775 )	21,287
Tenant refundable fees and security deposits	(2,186 )	(3,158 )	(16,770 )
Deferred revenue	(4,148 )	(1,735 )	7,593
Net cash provided by operating activities	268,427	228,244	237,220
<b>Cash Flows from Investing Activities</b>			
(Increase) decrease in lease security deposits and lease acquisition deposits, net	(3,088 )	(2,175 )	2,441
Decrease (increase) in cash and escrow deposits – restricted	56,176	4,705	(64,540 )
Net proceeds from sale of assets	30,817	12,079	14,941
Additions to property, plant and equipment, and leasehold intangibles, net of related payables	(160,131 )	(93,681 )	(117,453 )
Purchase of marketable securities — restricted	(32,724 )		
Sale of marketable securities — restricted	1,431		
	(88,682 )	(57,948 )	(204,137 )



Acquisition of assets, net of related payables and cash received			
Purchase of Horizon Bay Realty, L.L.C., net of cash acquired	5,516		
Payments on (issuance of) notes receivable, net	1,484	1,079	(508 )
Investment in unconsolidated ventures	(13,990 )	(660 )	(1,246 )
Proceeds from sale leaseback transaction			9,166
Distributions received from unconsolidated ventures	206	97	1,061
Proceeds from sale of unconsolidated venture	—	675	8,843
Other	(914 )	(676 )	
Net cash used in investing activities	(203,899 )	(136,505 )	(351,432 )
Cash Flows from Financing Activities			
Proceeds from debt	482,669	414,795	157,039
Proceeds from issuance of convertible notes, net	308,212		
Issuance of warrants	45,066		
Purchase of bond hedge	(77,007 )		
Repayment of debt and capital lease obligations	(898,565 )	(476,527 )	(32,587 )

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	For the Years Ended December 31,		
	2011	2010	2009
Proceeds from line of credit	225,000	60,000	60,446
Repayment of line of credit	(160,000 )	(60,000 )	(219,899 )
Payment of financing costs, net of related payables	(8,712 )	(8,541 )	(8,700 )
Proceeds from public equity offering, net			163,771
Other	(1,287 )	(763 )	(931 )
Refundable entrance fees:			
Proceeds from refundable entrance fees	29,611	36,420	30,386
Refunds of entrance fees	(25,754 )	(21,060 )	(22,916 )
Cash portion of loss on extinguishment of debt	(17,040 )	(179 )	
Recouping and payment of swap termination	(99 )	(20,427 )	
Purchase of treasury stock	(17,613 )		
Net cash (used in) provided by financing activities	(115,519 )	(76,282 )	126,609
Net (decrease) increase in cash and cash equivalents	(50,991 )	15,457	12,397
Cash and cash equivalents at beginning of year	81,827	66,370	53,973
Cash and cash equivalents at end of year	\$ 30,836	\$ 81,827	\$ 66,370

See accompanying notes to consolidated financial statements.

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BROOKDALE SENIOR LIVING INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Organization

Brookdale Senior Living Inc. (“Brookdale”, “BSL” or the “Company”) is a leading owner and operator of senior living communities throughout the United States. The Company provides an exceptional living experience through properties that are designed, purpose-built and operated to provide the highest quality service, care and living accommodations for residents. The Company owns, leases and operates retirement centers, assisted living and dementia-care communities and continuing care retirement centers (“CCRCs”).

The Company was formed as a Delaware corporation on June 28, 2005. Under its Certificate of Incorporation, the Company was initially authorized to issue up to 5,000,000 shares of common stock and 5,000,000 shares of preferred stock. On September 30, 2005, the Company’s Certificate of Incorporation was amended and restated to authorize up to 200,000,000 shares of common stock and 50,000,000 shares of preferred stock.

2. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (“GAAP”). The significant accounting policies are summarized below:

Principles of Consolidation

The consolidated financial statements include BSL and its wholly-owned subsidiaries Brookdale Living Communities, Inc. (“BLC”), Brookdale Senior Living Communities, Inc. (formerly known as Alterra Healthcare Corporation) (“Alterra”), Fortress CCRC Acquisition LLC (“Fortress CCRC”), American Retirement Corporation (“ARC”) and BKD HB Acquisition Sub, Inc. (“HB”). In December 2003, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Codification (“ASC”) 810 - Consolidation of Variable Interest Entities (“ASC 810”). ASC 810 addresses the identification of variable interest entities (“VIE”) consolidation by business enterprises deemed to be primary beneficiaries in the VIE. The Company identifies the primary beneficiary of a VIE as the enterprise that has both of the following characteristics: (i) the power to direct the activities of the VIE that most significantly impact the entity’s economic performance; and (ii) the obligation to absorb losses or receive benefits of the VIE that could potentially be significant to the entity. The Company performs this analysis on an ongoing basis. At December 31, 2011, the Company did not have any unconsolidated VIEs. Investments in affiliated companies that the Company does not control, but has the ability to exercise significant influence over governance and operation, are accounted for by the equity method.

The results of facilities and companies acquired are included in the consolidated financial statements from the effective date of the respective acquisition. All significant intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of the financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, revenue, goodwill and asset impairments, future service obligations, self-insurance reserves, performance-based compensation, the allowance for doubtful accounts,

depreciation and amortization, income taxes and other contingencies. Although these estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future, actual results may differ from the estimates.

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### Revenue Recognition

#### Resident Fees

Resident fee revenue is recorded when services are rendered and consists of fees for basic housing, support services and fees associated with additional services such as personalized health and assisted living care. Residency agreements are generally for a term of 30 days to one year, with resident fees billed monthly in advance. Revenue for certain skilled nursing services and ancillary charges is recognized as services are provided and is billed monthly in arrears.

#### Entrance Fees

Certain of the Company's communities have residency agreements which require the resident to pay an upfront fee prior to occupying the community. In addition, in connection with the Company's MyChoice program, new and existing residents are allowed to pay additional entrance fee amounts in return for a reduced monthly service fee. The non-refundable portion of the entrance fee is recorded as deferred revenue and amortized over the estimated stay of the resident based on an actuarial valuation. 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 such instances the refundable portion of the fee is not amortized and included in refundable entrance fees and deferred revenue.

Certain contracts require the refundable portion of the entrance fee plus a percentage of the appreciation of the unit, if any, to be refunded only upon resale of a comparable unit ("contingently refundable"). Upon resale the Company may receive reoccupancy proceeds in the form of additional contingently refundable fees, refundable fees, or non-refundable fees. The Company estimates the amount of reoccupancy proceeds to be received from additional contingently refundable fees or non-refundable fees and records such amount as deferred revenue. The deferred revenue was approximately \$48.1 million and \$52.9 million at December 31, 2011 and 2010, respectively and is amortized over the life of the community. All remaining contingently refundable fees not recorded as deferred revenue and amortized are included in refundable entrance fees and deferred revenue.

All refundable amounts due to residents at any time in the future, including those recorded as deferred revenue, are classified as current liabilities.

The non-refundable portion of entrance fees expected to be earned and recognized in revenue in one year is recorded as a current liability. The balance of the non-refundable portion is recorded as a long-term liability.

#### Community Fees

Substantially all community fees received are non-refundable and are recorded initially as deferred revenue. The deferred amounts, including both the deferred revenue and the related direct resident lease origination costs, are amortized over the estimated stay of the resident which is consistent with the implied contractual terms of the resident lease.

#### Management Fees

Management fee revenue is recorded as services are provided to the owners of the communities. Revenues are determined by an agreed upon percentage of gross revenues (as defined). Incentives and penalties receivable or payable under management contracts containing such provisions (other than contractual termination fees) are recorded

based on the amounts that would be due pursuant to the contractual arrangements if the contracts were terminated on the reporting date.

#### Reimbursed Costs Incurred on Behalf of Managed Communities

The Company manages certain communities under contracts which provide for payment to the Company of a monthly management fee plus reimbursement of certain operating expenses. Where the Company is the primary obligor with respect to any such operating expenses, the Company recognizes revenue when the goods have been delivered or the service has been rendered and the Company is due reimbursement. Such revenue is included in

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“reimbursed costs incurred on behalf of managed communities” on the consolidated statements of operations. The related costs are included in “costs incurred on behalf of managed communities” on the consolidated statements of operations.

### Purchase Accounting

In determining the allocation of the purchase price of companies and communities to net tangible and identified intangible assets acquired and liabilities assumed, the Company makes estimates of fair value using information obtained as a result of pre-acquisition due diligence, marketing, leasing activities and/or independent appraisals. The Company allocates the purchase price of communities based on their fair values in accordance with the provisions of ASC 805 - Business Combinations (“ASC 805”). The determination of fair value involves the use of significant judgment and estimation. The Company determines fair values as follows:

Current assets and current liabilities assumed are valued at carryover basis which approximates fair value.

Property, plant and equipment are valued utilizing discounted cash flow projections of future revenue and costs, and capitalization and discount rates using current market conditions.

The Company allocates a portion of the purchase price to the value of resident leases acquired based on the difference between the communities valued with existing in-place leases adjusted to market rental rates and the communities valued with current leases in place based on current contractual terms. Factors management considers in its analysis include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar resident leases. In estimating carrying costs, management includes estimates of lost rentals during the lease-up period and estimated costs to execute similar leases. The value of in-place leases is amortized to expense over the remaining initial term of the respective leases.

Leasehold operating intangibles are valued utilizing discounted cash flow projections that assume certain future revenues and costs over the remaining lease term. The value assigned to leasehold operating intangibles is amortized on a straight-line basis over the lease term.

Community purchase options are valued at the estimated value of the underlying community less the cost of the option payment discounted at current market rates. Management contracts and other acquired contracts are valued at a multiple of management fees and operating income or are valued utilizing discounted cash flow projections that assume certain future revenues and costs over the remaining contract. The assets are then amortized over the estimated term of the agreement.

Long-term debt assumed is recorded at fair market value based on the current market rates and collateral securing the indebtedness. Any debt premium or discount recorded is amortized over the related debt maturity period.

Capital lease obligations are valued based on the present value of the minimum lease payments applying a discount rate equal to the Company’s estimated incremental borrowing rate at the date of acquisition.

Deferred entrance fee revenue is valued at the estimated cost of providing services to residents over the terms of the current contracts to provide such services. Refundable entrance fees are valued at cost pursuant to the resident lease plus the resident's share of any appreciation of the community unit at the date of acquisition, if applicable.

A deferred tax liability is recognized at statutory rates for the difference between the book and tax bases of the acquired assets and liabilities.

The excess of the fair value of liabilities assumed and cash paid over the fair value of assets acquired is allocated to goodwill.

Contingent consideration is valued using a probability-weighted discounted cash flow model.

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### Deferred Costs

Deferred financing and lease costs are recorded in other assets and amortized on a straight-line basis, which approximates the level yield method, over the term of the related debt or lease.

### Income Taxes

Income taxes are accounted for under the asset and liability approach which requires recognition of deferred tax assets and liabilities for the differences between the financial reporting and tax bases of assets and liabilities. A valuation allowance reduces deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company has elected the “with-and-without approach” regarding ordering of windfall tax benefits to determine whether the windfall tax benefit did reduce taxes payable in the current year. Under this approach, the windfall tax benefits would be recognized in additional paid-in capital only if an incremental tax benefit is realized after considering all other tax benefits presently available.

### Fair Value of Financial Instruments

Cash and cash equivalents, cash and escrow deposits-restricted, derivative financial instruments and marketable securities - restricted are reflected in the accompanying consolidated balance sheets at amounts considered by management to reasonably approximate fair value. Management estimates the fair value of its long-term debt using a discounted cash flow analysis based upon the Company’s current borrowing rate for debt with similar maturities and collateral securing the indebtedness. The Company had outstanding debt with a carrying value of approximately \$2.5 billion and \$2.6 billion as of December 31, 2011 and 2010, respectively. As of December 31, 2011 and 2010, the estimated fair value of debt was approximately \$2.5 billion.

ASC 820 - Fair Value Measurement (“ASC 820”) establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company’s marketable securities - restricted are valued based primarily on quoted market prices and are classified within Level 1 of the valuation hierarchy.

The Company’s derivative positions are valued using models developed internally by the respective counterparty that use as their basis readily observable market parameters (such as forward yield curves) and are classified within Level 2 of the valuation hierarchy.

The Company considers its own credit risk as well as the credit risk of its counterparties when evaluating the fair value of its derivatives. Any adjustments resulting from credit risk are recorded as a change in fair value of derivatives

and amortization in the current period statement of operations (Note 18).

The Company's fair value of debt disclosure is determined based primarily on market interest rate assumptions of similar debt applied to future cash flows under the debt agreements and is classified within Level 2 of the valuation hierarchy.

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## Cash and Cash Equivalents

The Company defines cash and cash equivalents as cash and investments with maturities of 90 days or less when purchased.

## Cash and Escrow Deposits - Restricted

Cash and escrow deposits - restricted consist principally of deposits required by certain lenders and lessors pursuant to the applicable agreement and consist of the following (dollars in thousands):

	December 31,	
	2011	2010
Current:		
Real estate taxes	\$ 12,541	\$ 9,981
Tenant security deposits	4,374	4,591
Insurance reserves	12,904	12,728
Entrance fees	4,891	39,785
Replacement reserve and other	11,193	12,584
Subtotal	45,903	79,669
Long term:		
Insurance reserves	5,412	6,116
Debt service and other deposits	47,568	59,200
Subtotal	52,980	65,316
Total	\$ 98,883	\$ 144,985

As of December 31, 2011 and 2010, 12 and 10, respectively, communities located in Illinois are required to make escrow deposits under the Illinois Life Care Facility Act. As of December 31, 2011 and 2010, required deposits were \$20.1 million and \$19.6 million, respectively, all of which were made in the form of letters of credit.

## Accounts Receivable

Accounts receivable are reported net of an allowance for doubtful accounts, to represent the Company's estimate of the amount that ultimately will be realized in cash. The allowance for doubtful accounts was \$17.0 million and \$14.5 million as of December 31, 2011 and 2010, respectively. The adequacy of the Company's 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.

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. Contractual or cost related adjustments from Medicare or Medicaid are accrued when assessed (without regard to when the assessment is paid or withheld). Subsequent positive or negative adjustments to these accrued amounts are recorded in net revenues when known.

## Property, Plant and Equipment and Leasehold Intangibles

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Property, plant and equipment and leasehold intangibles, which include amounts recorded under capital leases, are recorded at cost. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets, which are as follows:

Asset Category	Estimated Useful Life (in years)
Buildings and improvements	40
Furniture and equipment	3 – 7
Resident lease intangibles	1 – 4

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Asset Category	Estimated Useful Life (in years)
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