



CONSOLIDATED FINANCIAL STATEMENTS

Aviv REIT, Inc. and Subsidiaries
As of December 31, 2010 and 2009, and for the Years Ended
December 31, 2010, 2009, and 2008
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Aviv REIT, Inc. and Subsidiaries

Consolidated Financial Statements

As of December 31, 2010 and 2009, and for the
Years Ended December 31, 2010, 2009, and 2008

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Report of Independent Auditors

The Stockholders
Aviv REIT, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Aviv REIT, Inc. and Subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 Aviv REIT, Inc. and Subsidiaries at December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

Chicago, Illinois
March 15, 2011

Aviv REIT, Inc. and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2010	2009
Assets		
Cash and cash equivalents	\$ 13,029,474	\$ 15,542,507
Deferred rent receivable	30,660,773	27,715,217
Due from related parties	–	15,816
Tenant receivables	1,168,842	2,407,737
Rental properties and financing leases, at cost:		
Land	76,466,020	69,844,477
Buildings and improvements	615,806,273	555,931,485
Assets under direct financing leases	10,777,184	10,633,306
	703,049,477	636,409,268
Less accumulated depreciation	(75,948,944)	(58,673,377)
Net rental properties	627,100,533	577,735,891
Deferred finance costs, net	9,957,636	989,658
Loan receivables	36,610,638	28,970,129
Other assets	12,872,323	11,753,540
Total assets	\$ 731,400,219	\$ 665,130,495
Liabilities and equity		
Accounts payable and accrued expenses	\$ 6,012,809	\$ 3,241,478
Tenant security and escrow deposits	13,658,384	12,314,790
Other liabilities	25,996,492	31,936,322
Mortgage and other notes payable	440,575,916	480,105,226
Total liabilities	486,243,601	527,597,816
Class E Preferred Units	–	62,970,571
Equity:		
Stockholders' equity:		
Common stock (par value \$0.01; 227,002 shares outstanding)	2,270	–
Additional paid-in-capital	223,838,999	–
Accumulated deficit	(2,261,839)	–
Accumulated other comprehensive income	2,188,155	–
Stockholders' equity	223,767,585	–
Partners' equity	–	73,385,093
Noncontrolling interests	21,389,033	1,177,015
Total equity	245,156,618	74,562,108
Total liabilities and equity	\$ 731,400,219	\$ 665,130,495

See accompanying notes.

Aviv REIT, Inc. and Subsidiaries

Consolidated Statements of Operations

	Year Ended December 31		
	2010	2009	2008
Revenues			
Rental income	\$ 84,490,144	\$ 82,775,078	\$ 72,142,847
Tenant recoveries	6,441,786	6,055,703	4,830,733
Interest on loans to lessees – capital expenditures	1,779,620	1,662,107	725,939
Interest on loans to lessees – working capital and capital lease	3,446,226	1,830,791	1,133,146
Total revenues	96,157,776	92,323,679	78,832,665
Expenses			
Rent and other operating expenses	574,646	612,185	1,088,220
General and administrative	10,725,122	7,741,087	6,808,795
Offering costs	–	6,863,948	–
Real estate taxes	6,475,230	6,231,776	5,116,431
Depreciation	17,853,799	17,527,656	14,615,770
Loss on impairment	96,000	–	931,629
Total expenses	35,724,797	38,976,652	28,560,845
Operating income	60,432,979	53,347,027	50,271,820
Other income and expenses:			
Interest and other income	133,286	466,177	2,012,046
Interest expense	(22,722,785)	(26,570,071)	(26,272,012)
Change in fair value of derivatives	2,931,309	6,987,825	(8,673,771)
Amortization of deferred financing costs	(1,008,059)	(550,327)	(536,620)
Gain on sale of assets, net	511,552	–	–
Loss on extinguishment of debt	(2,295,562)	–	–
Total other income and expenses	(22,450,259)	(19,666,396)	(33,470,357)
Income from continuing operations	37,982,720	33,680,631	16,801,463
Discontinued operations	–	–	72,730
Net income	37,982,720	33,680,631	16,874,193
Distributions and accretion on Class E Preferred Units	(17,371,893)	(14,569,875)	(8,842,980)
Net income allocable to common units of Partnership/noncontrolling interests	(16,779,731)	(19,110,756)	(8,031,213)
Net income allocable to stockholders	\$ 3,831,096	\$ –	\$ –
Net income	\$ 37,982,720		
Unrealized gain on derivative instrument, net of noncontrolling interest portion of \$1,906,277	2,188,155		
Comprehensive income allocable to stockholders	\$ 40,170,875		

See accompanying notes.

Aviv REIT, Inc. and Subsidiaries
Consolidated Statements of Changes in Equity
Years Ended December 31, 2010, 2009, and 2008

	Stockholders' Equity								
	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity	Partners' Equity	Noncontrolling Interests	Total Equity
	Shares	Amount							
Balance at January 1, 2008	–	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 92,835,547	\$ 1,422,456	\$ 94,258,003
Net income	–	–	–	–	–	–	16,719,167	155,026	16,874,193
Issuance of warrants	–	–	–	–	–	–	1,349,494	–	1,349,494
Non-cash stock-based compensation	–	–	–	–	–	–	406,000	–	406,000
Distributions to partners and accretion on Class E Preferred Units and other	–	–	–	–	–	–	(34,394,877)	(621,621)	(35,016,498)
Balance at January 1, 2009	–	–	–	–	–	–	76,915,331	955,861	77,871,192
Net income	–	–	–	–	–	–	33,459,477	221,154	33,680,631
Issuance of warrants	–	–	–	–	–	–	8,399,117	–	8,399,117
Non-cash unit-based compensation	–	–	–	–	–	–	406,000	–	406,000
Distributions to partners and accretion on Class E Preferred Units and other	–	–	–	–	–	–	(45,794,832)	–	(45,794,832)
Balance at December 31, 2009	–	–	–	–	–	–	73,385,093	1,177,015	74,562,108
Net income	–	–	–	–	–	–	30,583,743	230,305	30,814,048
Non-cash unit-based compensation	–	–	–	–	–	–	304,500	–	304,500
Distributions to partners and accretion on Class E Preferred Units and other	–	–	–	–	–	–	(68,635,411)	–	(68,635,411)
Capital contributions	–	–	–	–	–	–	–	268,902	268,902
Redemption of warrants	–	–	–	–	–	–	(17,001,453)	–	(17,001,453)
Reclassification of equity at Merger date	–	–	–	–	–	–	(18,636,472)	18,636,472	–
Subtotal at September 17, 2010 (Merger – See Note 1)	–	–	–	–	–	–	–	20,312,694	20,312,694
Non-cash stock (unit)-based compensation	–	–	337,598	–	–	337,598	–	989,900	1,327,498
Distributions to partners	–	–	–	–	–	–	–	(5,251,962)	(5,251,962)
Capital contributions	227,002	2,270	234,977,172	–	–	234,979,442	–	94,548	235,073,990
Cost of raising capital	–	–	(11,475,771)	–	–	(11,475,771)	–	–	(11,475,771)
Unrealized gain on derivative instruments	–	–	–	–	2,188,155	2,188,155	–	1,906,277	4,094,432
Dividends to stockholders	–	–	–	(6,092,935)	–	(6,092,935)	–	–	(6,092,935)
Net income	–	–	–	3,831,096	–	3,831,096	–	3,337,576	7,168,672
Balance at December 31, 2010	227,002	\$ 2,270	\$ 223,838,999	\$ (2,261,839)	\$ 2,188,155	\$ 223,767,585	\$ –	\$ 21,389,033	\$ 245,156,618

See accompanying notes.

Aviv REIT, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31		
	2010	2009	2008
Operating activities			
Net income	\$ 37,982,720	\$ 33,680,631	\$ 16,874,193
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	17,853,799	17,527,656	14,661,586
Amortization	1,008,059	550,327	536,620
Change in fair value of derivatives	(2,931,309)	(6,987,825)	8,673,771
Deferred rental income	(3,056,430)	(6,388,600)	(5,531,005)
Rental income from intangible amortization, net	(3,681,109)	(2,097,655)	(2,518,376)
Non-cash stock (unit)-based compensation	1,631,998	406,000	406,000
Gain on sale of assets, net	(511,552)	-	-
Non-cash loss on extinguishment of debt	1,437,233	-	-
Loss on impairment of assets	96,000	-	931,629
Loss on disposal of assets, net	-	-	183,903
Reserve for uncollectible loans	750,000	-	-
Changes in assets and liabilities:			
Due from related parties	15,816	10,000	642,662
Tenant receivables	(317,123)	(365,523)	(2,087,939)
Other assets	177,666	3,022,578	(2,439,953)
Accounts payable and accrued expenses	3,357,961	145,652	1,634,170
Tenant security deposits and other liabilities	866,527	1,141,304	978,499
Due to related parties	-	(602,253)	(897,456)
Net cash provided by operating activities	54,680,256	40,042,292	32,048,304
Investing activities			
Purchase of rental properties	(54,884,043)	(16,375,694)	(94,392,262)
Sales of rental properties	4,085,825	-	3,071,177
Payment of earn-out provision for previously acquired rental properties	(9,600,731)	-	-
Capital improvements and other developments	(7,883,130)	(13,507,673)	(1,833,252)
Proceeds of collections on loan receivables to related parties	-	-	32,000,000
Loan receivables funded to others, net	(6,834,568)	(8,609,528)	(17,440,989)
Funding of direct financing leases, net	-	-	(10,479,323)
Net cash used in investing activities	(75,116,647)	(38,492,895)	(89,074,649)

Aviv REIT, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (continued)

	December 31		
	2010	2009	2008
Financing activities			
Borrowings of debt	\$ 442,789,570	\$ 35,651,073	\$ 80,915,249
Repayment of debt	(482,522,690)	(19,091,756)	(4,218,338)
Payment of financing costs	(10,567,931)	(102,803)	–
Payment for swap termination	(3,380,160)	–	–
Capital contributions	235,342,892	–	–
Cost of raising capital	(11,475,771)	–	–
Redemption of Class E Preferred Units and warrants	(92,001,451)	–	–
Redemption of Class F Units	(23,602,649)	–	–
Proceeds from issuance of warrants	–	8,399,117	1,349,494
Net proceeds from issuance of Class E Preferred Units	–	17,898,975	1,813,836
Cash distributions to partners	(36,658,452)	(38,122,989)	(29,849,750)
Net cash provided by financing activities	<u>17,923,358</u>	<u>4,631,617</u>	<u>50,010,491</u>
Net (decrease) increase in cash and cash equivalents	<u>(2,513,033)</u>	<u>6,181,014</u>	<u>(7,015,854)</u>
Cash and cash equivalents:			
Beginning of year	<u>15,542,507</u>	<u>9,361,493</u>	<u>16,377,347</u>
End of year	<u>\$ 13,029,474</u>	<u>\$ 15,542,507</u>	<u>\$ 9,361,493</u>
Supplemental cash flow information			
Cash paid for interest	\$ 20,983,000	\$ 27,771,260	\$ 25,447,062
Supplemental disclosure of non-cash activity			
Accrued dividends payable to stockholders	\$ 6,092,935	\$ –	–
Accrued distributions payable to partners	\$ 5,246,840	\$ 3,650,000	\$ 395,046
Write-off of deferred rent receivable	\$ 3,367,164	\$ –	–
Write-off of in-place lease intangibles, net	\$ 1,392,034	\$ –	–
Write-off of deferred finance costs, net	\$ 1,235,969	\$ –	–
Write-off of debt discount	\$ 202,307	\$ –	–
Mortgage and other notes payable assumed	\$ –	\$ –	\$ 5,350,939

See accompanying notes.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

As of December 31, 2010 and 2009, and for
the Years Ended December 31, 2010, 2009, and 2008

1. Description of Operations and Formation

Aviv REIT, Inc., a Maryland corporation, and Subsidiaries (the REIT) is the sole general partner of Aviv Healthcare Properties Limited Partnership, a Delaware limited partnership, and Subsidiaries (the Partnership). The Partnership is a majority-owned subsidiary that owns all of the real estate properties. In these Notes, the Company refers generically to Aviv REIT, Inc., the Partnership, and their subsidiaries. The Partnership was formed in 2005 and directly or indirectly owned or leased 181 and 169 properties, principally skilled nursing facilities, across the United States at December 31, 2010 and 2009, respectively. The Company generates the majority of its revenues by entering into long-term triple-net leases with qualified local, regional, and national operators. In addition to the base rent, leases provide for tenants to pay the Company an ongoing escrow for real estate taxes. Furthermore, all operating and maintenance costs of the buildings are the responsibility of the tenants. Substantially all depreciation expense reflected in the consolidated statements of operations relates to the ownership of senior living properties. The Company manages its business as a single business segment as defined in Accounting Standards Codification (ASC) 280, *Segment Reporting*.

The Partnership is the general partner of Aviv Healthcare Properties Operating Partnership I, L.P. (the Operating Partnership), a Delaware limited partnership. The Operating Partnership has six wholly owned subsidiaries: Aviv Development JV, LLC (Aviv Development), a Delaware limited liability company; Aviv Financing I, LLC (Aviv Financing I), a Delaware limited liability company; Aviv Financing II, LLC (Aviv Financing II), a Delaware limited liability company; Aviv Financing III, LLC (Aviv Financing III), a Delaware limited liability company; Aviv Financing IV, LLC (Aviv Financing IV), a Delaware limited liability company; and Aviv Financing V, LLC (Aviv Financing V), a Delaware limited liability company.

On September 17, 2010, the Partnership entered into an agreement (the Merger Agreement), by and among the REIT, Aviv Healthcare Merger Sub LP (Merger Sub), a Delaware limited partnership of which the REIT is the general partner, Aviv Healthcare Merger Sub Partner LLC, a Delaware limited liability company and a wholly owned subsidiary of the REIT, and the Partnership. Pursuant to the Merger Agreement, the Partnership merged with and into Merger Sub (the Merger), with Merger Sub continuing as the surviving entity with the identical name (the Surviving Partnership). Following the Merger, the REIT remains as the sole general partner of the Surviving Partnership and the Surviving Partnership, as the successor to the Partnership, became the general partner of the Operating Partnership. All of the business,

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Description of Operations and Formation (continued)

assets, and operations will continue to be held by the Operating Partnership and its subsidiaries. The REIT's equity interest in the Surviving Partnership will be linked to future investments in the REIT, such that future equity issuances by the REIT (pursuant to the Stockholders Agreement, the REIT's management incentive plan, or otherwise as agreed between the parties) will result in a corresponding increase in the REIT's equity interest in the Surviving Partnership. The REIT is authorized to issue two million shares of common stock (par value \$0.01) and 1,000 shares of preferred stock (par value \$1,000). At December 31, 2010, there are 227,002 shares of common stock and 125 shares of preferred stock outstanding. Dividends on each outstanding share of preferred stock accrue on a daily basis at the rate of 12.5% per annum of the sum of \$1,000 plus all accumulated and unpaid dividends thereon which are in arrears. The REIT makes annual distributions on the shares in the aggregate amount of \$15,625 per year. With respect to the payment of dividends or other distributions and the distribution of the REIT's assets upon dissolution, liquidation, or winding up, the preferred stock will be senior to all other classes and series of stock of the REIT. Due to the immateriality, the preferred stock has not been shown separately in the consolidated balance sheets.

As a result of the common control of the REIT (which was newly formed) and the Partnership, the Merger, for accounting purposes, did not result in any adjustment to the historical carrying value of the assets or liabilities of the Partnership. The REIT was funded in September 2010 with approximately \$235 million from its stockholders. The REIT contributed the net proceeds of its capital raise to the Partnership in exchange for Class G Units in the Partnership. Periods prior to September 17, 2010 represent the results of operations and financial condition of the Partnership, as predecessor to the Company.

The operating results of the Surviving Partnership are allocated based upon the respective economic interests therein. For the period from September 17, 2010 through December 31, 2010, the REIT owned 53.4% of the Surviving Partnership.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies

Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Noncontrolling Interests

In December 2007, the Financial Accounting Standards Board (FASB) issued ASC 810, *Consolidations* (ASC 810), to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. ASC 810 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008.

Effective January 1, 2009, the Company retrospectively adopted the provisions of ASC 810, which requires a noncontrolling interest in a subsidiary to be reported as equity and the amount of consolidated net income specifically attributable to the noncontrolling interest to be included within consolidated net income.

ASC 810 also requires consistency in the manner of reporting changes in the parent's ownership interest and requires fair value measurement of any noncontrolling equity investment retained in a deconsolidation. Further, as a result of the adoption of ASC 810, net income attributable to noncontrolling interests is now excluded from the determination of consolidated net income.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the REIT, the Surviving Partnership, the Operating Partnership, and all controlled subsidiaries and joint ventures. The Company considers itself to control an entity if it is the majority owner of and has voting control over such entity. The portion of the net income or loss attributed to third

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

parties is reported as net income allocable to noncontrolling interests on the consolidated statements of operations, and such parties' portion of the net equity in such subsidiaries is reported on the consolidated balance sheets as noncontrolling interests. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid short-term investments with original maturities of three months or less. The Company maintains cash and cash equivalents in United States banking institutions that exceed amounts insured by the Federal Deposit Insurance Corporation. The Company believes the risk of loss from exceeding this insured level is minimal.

Rental Properties

The Company periodically assesses the carrying value of rental properties and related intangible assets in accordance with ASC 360, *Property, Plant, and Equipment* (ASC 360), to determine if facts and circumstances exist that would suggest that assets might be impaired or that the useful lives should be modified. In the event impairment in value occurs and a portion of the carrying amount of the rental properties will not be recovered in part or in whole, a provision will be recorded to reduce the carrying basis of the rental properties and related intangibles to their estimated fair value. The estimated fair value of the Company's rental properties is determined by using customary industry standard methods that include discounted cash flow and/or direct capitalization analysis. As part of the impairment evaluation during 2010, a building in Hometown, Texas, was impaired for \$96,000 to reflect the difference between the book value and estimated selling price less costs to dispose. The property was sold on December 31, 2010, with an immaterial gain subsequent to the impairment of \$96,000 previously taken. As part of the impairment evaluation during 2008, the Company recorded a loss on the anticipated sale of a building of approximately \$932,000.

Buildings and building improvements have been assigned estimated 40-year lives and are depreciated on the straight-line method. Personal property, furniture, and equipment have been assigned estimated lives ranging from 7 to 10 years and are depreciated on the straight-line method.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The Company may advance monies to its lessees for the purchase, generally, of furniture, fixtures, or equipment or other purposes. Required minimum lease payments due from the lessee increase to provide for the repayment of such amounts over a stated term. These advances in the instance where the depreciable life of the newly purchased asset is less than the remaining lease term are reflected as loan receivables on the consolidated balance sheets, and the incremental lease payments are bifurcated between principal and interest over the stated term. In the instance where the depreciable life of the newly purchased assets is longer than the remaining lease term, the purchase is recorded as property. In other instances, explicit loans are made to lessees for working capital and other funding needs and provide for monthly principal and interest payments generally ranging from 5 to 10 years. Such advances, net of repayments, equaled \$36,610,638 and \$28,970,129 at December 31, 2010 and 2009, respectively.

Purchase Accounting

In determining the allocation of the purchase price of partnerships and facilities between net tangible and identified intangible assets acquired and liabilities assumed, the Company makes estimates of the fair value of the tangible and intangible assets and acquired liabilities using information obtained from multiple sources as a result of preacquisition due diligence, marketing, leasing activities of the Company's diverse operator base, industry surveys of critical valuation metrics such as capitalization rates, discount rates, and leasing rates, and appraisals obtained as a requirement of the Mortgage. The Company allocates the purchase price of facilities to net tangible and identified intangible assets acquired 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:

- Other assets acquired and other liabilities assumed are valued at stated amounts, which approximate fair value.
- Rental properties are valued using discounted cash flow projections that assume certain future revenue and costs and consider capitalization and discount rates using current market conditions. The Company allocates the purchase price of facilities to net tangible and identified intangible assets acquired and liabilities assumed based on their fair values.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

- Assumed debt balances are valued at fair value, with the computed discount/premium amortized over the remaining term of the obligation.

The Company determines the value of land either based on real estate tax-assessed values in relation to the total value of the asset, internal analyses of recently acquired and existing comparable properties within the Company's portfolio, or third-party appraisals. The fair value of in-place leases, if any, reflects: (i) above- and below-market leases, if any, determined by discounting the difference between the estimated current market rent and the in-place rentals, the resulting intangible asset or liability of which is amortized to rental revenue over the remaining life of the associated lease plus any fixed rate renewal periods, if applicable; (ii) the estimated value of the cost to obtain tenants, including tenant allowances, tenant improvements, and leasing commissions, which is amortized over the remaining life of the associated lease; and (iii) an estimated value of the absorption period to reflect the value of the rents and recovery costs foregone during a reasonable lease-up period as if the acquired space was vacant, which is amortized over the remaining life of the associated lease. The Company also estimates the value of tenant or other customer relationships acquired by considering the nature and extent of existing business relationships with the tenant, growth prospects for developing new business with such tenant, such tenant's credit quality, expectations of lease renewals with such tenant, and the potential for significant, additional future leasing arrangements with such tenant. The Company amortizes such value, if any, over the expected term of the associated arrangements or leases, which would include the remaining lives of the related leases. The amortization is included in the consolidated statements of operations in rental income.

Prior to the Merger on September 17, 2010, Aviv Asset Management, L.L.C. (AAM) was a non-consolidated management company to the Partnership based on the application of appropriate accounting guidance (as discussed in Note 11). Upon the Merger, AAM became a consolidated entity of the Company and is presented as such for all periods included herein with all periods shown at historical cost (carryover basis with no adjustments to fair value). This treatment is in accordance with ASC 805 due to the fact that AAM was under common control prior and subsequent to the Merger.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition

Rental income is recognized on a straight-line basis over the term of the lease when collectibility is reasonably assumed. Differences between rental income earned and amounts due under the lease are charged or credited, as applicable, to deferred rent receivable. Income recognized from this policy is titled deferred rental revenue. Additional rents from expense reimbursements for insurance, real estate taxes, and certain other expenses are recognized in the period in which the related expenses are incurred and are reflected as tenant recoveries on the consolidated statements of operations.

Below is a summary of the components of rental income for the years ended December 31, 2010, 2009, and 2008:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Rental income	\$ 77,752,605	\$ 74,288,823	\$ 64,093,466
Deferred rental revenue	3,056,430	6,388,600	5,531,005
Rental income from intangible amortization	3,681,109	2,097,655	2,518,376
Total rental income	<u>\$ 84,490,144</u>	<u>\$ 82,775,078</u>	<u>\$ 72,142,847</u>

During the year ended December 31, 2010, deferred rental revenue includes an offsetting write-off (expense) of deferred rent receivable of \$3,367,164 due to the terminations of leases and replacement of operators.

Lease Accounting

The Company, as lessor, makes a determination with respect to each of its leases whether they should be accounted for as operating leases or direct financing leases. The classification criteria is based on estimates regarding the fair value of the leased facilities, minimum lease payments, effective cost of funds, the economic life of the facilities, the existence of a bargain purchase option, and certain other terms in the lease agreements. Payments received under operating leases are accounted for in the consolidated statements of operations as rental income for actual rent collected plus or minus a straight-line adjustment for estimated minimum lease escalators. Assets subject to operating leases are

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

reported as rental properties in the consolidated balance sheets. For facilities leased as direct financing arrangements, an asset equal to the Company's net initial investment is established on the consolidated balance sheets titled assets under direct financing leases. Payments received under the financing lease are bifurcated between interest income and principal amortization to achieve a consistent yield over the stated lease term using the interest method. Principal amortization (accretion) is reflected as an adjustment to the asset subject to a financing lease. Such accretion was \$143,878, \$153,983, and \$95,793 for the years ended December 31, 2010, 2009, and 2008, respectively.

All of the Company's 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.

Deferred Finance Costs

Deferred finance costs are being amortized using the straight-line method, which approximates the interest method, over the term of the respective underlying debt agreement.

Loan Receivables

Loan receivables consist of capital improvement loans to tenants and working capital loans to operators. Loan receivables are carried at their principal amount outstanding. Management periodically evaluates outstanding loans and notes receivable for collectibility. When management identifies potential loan impairment indicators, such as nonpayment under the loan documents, impairment of the underlying collateral, financial difficulty of the operator, or other circumstances that may impair full execution of the loan documents, and management believes it is probable that all amounts will not be collected under the contractual terms of the loan, the loan is written down to the present value of the expected future cash flows. As of December 31, 2010, loan receivable reserves amounted to \$750,000. No other circumstances exist that would suggest that additional reserves are necessary at the balance sheet date. As of December 31, 2009, loan receivable reserves are immaterial.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Stock-Based Compensation

The Company follows ASC 718, *Compensation – Stock Compensation* (ASC 718), which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated statements of operations based on their grant date fair values. On September 17, 2010, the Company adopted a 2010 Management Incentive Plan (the Plan) as part of the Merger transaction. A pro rata allocation of non-cash stock-based compensation expense is made to the Company for awards granted under the Plan. The Plan's non-cash stock-based compensation expense by the Company since the Merger date through December 31, 2010 is summarized in Note 9.

Fair Value of Financial Instruments

ASC 820, *Fair Value Measurements and Disclosures* (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.
- 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 interest rate swaps are valued using models developed internally by the respective counterparty that use as their basis readily observable market parameters and are classified within Level 2 of the valuation hierarchy.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Cash and cash equivalents, cash and escrow deposits – restricted, and derivative financial instruments 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 mortgage and other notes payable obligations with a carrying value of approximately \$440.6 million and \$480.1 million as of December 31, 2010 and 2009, respectively. The estimated fair value of debt (Level 2) as of December 31, 2010 approximated its carrying value based upon interest rates available to the Company on similar borrowings and was \$458.4 million as of December 31, 2009.

Derivative Instruments

The Company has implemented ASC 815, *Derivatives and Hedging* (ASC 815), which establishes accounting and reporting standards requiring that all derivatives, including certain derivative instruments embedded in other contracts, be recorded as either an asset or liability measured at their fair value unless they qualify for a normal purchase or normal sales exception. When specific hedge accounting criteria are not met, ASC 815 requires that changes in a derivative's fair value be recognized currently in earnings. Changes in the fair market values of the Company's derivative instruments are recorded in the consolidated statements of operations if the derivative does not qualify for or the Company does not elect to apply hedge accounting. If the derivative is deemed to be eligible for hedge accounting, such changes are reported in accumulated other comprehensive income within the consolidated statements of changes in equity, exclusive of ineffectiveness amounts, which are recognized as adjustments to net income.

Initial Public Offering Costs

During 2009, the Company pursued an initial public offering (the IPO) of common stock. Costs related to the IPO incurred by the Company were capitalized on the consolidated balance sheets in other assets as they were incurred.

On November 2, 2009, the Company abandoned its IPO effort. As a result, the Company wrote off the IPO costs incurred to date to the consolidated statements of operations. In the year ended December 31, 2009, approximately \$6.9 million of IPO-related costs were expensed.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Income Taxes

For federal income tax purposes, the Company intends to elect, with the filing of its initial 1120 REIT, U.S. Income Tax Return for Real Estate Investment Trusts, to be taxed as a Real Estate Investment Trust (REIT) effective at the time of the Merger. To qualify as a REIT, the Company must meet certain organizational, income, asset, and distribution tests. The Company currently intends to comply with these requirements and maintain REIT status. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may not elect REIT status for four subsequent years. However, the Company may still be subject to federal excise tax. In addition, the Company may be subject to certain state and local income and franchise taxes. Historically, the Company and its predecessor have generally only incurred certain state and local income and franchise taxes, but these amounts were immaterial in any of the years presented. Prior to the Merger, the Partnership was a limited partnership and the consolidated operating results were included in the income tax returns of the individual partners. No uncertain income tax positions exist as of December 31, 2010 and 2009.

The rental properties of the Company have an income tax basis of approximately \$598,846,000 as of December 31, 2010.

Dividends paid to common stockholders, for federal income tax purposes, are as follows:

	Year Ended December 31 2010
Per share:	
Ordinary income	\$ 12.52
Return of capital	14.30
Total	<u>\$ 26.82</u>

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Risks and Uncertainties

The Company is subject to certain risks and uncertainties affecting the healthcare industry as a result of healthcare legislation and continuing regulation by federal, state, and local governments. Additionally, the Company is subject to risks and uncertainties as a result of changes affecting operators of nursing home facilities due to the actions of governmental agencies and insurers to limit the growth in cost of healthcare services.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current financial statement presentation, with no effect on the Company's consolidated financial position or results of operations.

3. Rental Property Activity

The Company had the following rental property activity during 2010, as described below:

- In March 2010, Aviv Financing III recognized an \$8,121,000 addition to the purchase price for the August 2008 acquisitions of eight properties in California and Oregon from an unrelated third party as per the guidance within ASC 805. The addition is related to the earn-out provision defined at closing. Such \$8,121,000 addition along with \$1,480,000 in previously accrued amounts at December 31, 2009 related to the acquisitions of two properties in April 2009 in California and Nevada under Aviv Financing I was paid out in the amount of approximately \$9,601,000.
- In June 2010, Aviv Financing III acquired a property in Tennessee from an unrelated third party for a purchase price of approximately \$3,380,000. The Company financed this purchase through cash.
- In July 2010, Aviv Financing I disposed of two properties in California to an unrelated third party for a total selling price of approximately \$3,988,000, which resulted in a gain on disposal of approximately \$582,000. The proceeds from the sale were primarily used to pay down a portion of the existing Credit Facility (see Note 7) by approximately \$3,883,000.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Rental Property Activity

- In September 2010, Aviv Financing I acquired a property in Virginia from an unrelated third party for a purchase price of approximately \$5,000,000. The Company financed this purchase through borrowings of approximately \$3,162,000 under the Revolver (see Note 7).
- In October 2010, Aviv Financing I acquired four properties in Missouri from various unrelated third parties for a purchase price of approximately \$10,460,000. The Company financed this purchase through borrowings of approximately \$7,718,000 under the Revolver (see Note 7).
- In November 2010, Aviv Financing III acquired a property in California from an unrelated third party for a purchase price of approximately \$11,500,000. The Company financed this purchase through borrowings of approximately \$7,800,000 under an acquisition loan.
- In December 2010, Aviv Financing III acquired a property in Connecticut from an unrelated third party for a purchase price of approximately \$2,600,000. The Company financed this purchase through cash.
- In December 2010, Aviv Financing I acquired four properties in Kansas, Texas, and Connecticut from unrelated third parties for a purchase price of approximately \$21,944,000. The Company financed this purchase through borrowings of approximately \$15,666,000 under the Revolver (see Note 7).
- In December 2010, Aviv Financing I sold a property located in Texas to an unrelated third party for a sales price of approximately \$96,000.

In accordance with ASC 805, the Company allocated the approximate net purchase price of these properties acquired in 2010 as follows:

Land	\$ 7,094,000
Buildings and improvements	55,911,000
Borrowings and available cash	<u>\$ 63,005,000</u>

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Rental Property Activity (continued)

The Company had the following rental property activity during 2009, as described below:

- In January 2009, Aviv Financing III acquired a property in Arkansas from an unrelated third party for a purchase price of approximately \$5,250,000. The Company financed this purchase through borrowings of approximately \$2,625,000 via an acquisition loan, which was subsequently paid in full in August 2009.
- In April 2009, Aviv Financing III acquired two properties in California and Nevada from an unrelated third party for a purchase price of approximately \$12,606,000. The Company financed this purchase through borrowings of approximately \$8,625,000 via an acquisition loan.

In accordance with ASC 805, the Company allocated the approximate net purchase price of these properties acquired in 2009 as follows:

Land	\$ 4,675,000
Buildings and improvements	<u>13,181,000</u>
Borrowings and available cash	<u>\$ 17,856,000</u>

The Company acquired additional rental properties during 2008, as described below:

- In April 2008, Aviv Financing I acquired vacant land in Arkansas from an unrelated third party for a purchase price of approximately \$625,000 to be used for construction of a replacement facility and acquired two properties in Arkansas from an unrelated third party for a purchase price of approximately \$12,800,000. The Company financed this purchase through borrowings of approximately \$9,785,000 under the Credit Facility and from proceeds from the issuance of Class E Units.
- In August 2008, Aviv Financing I acquired eight properties in California and Oregon from an unrelated third party for a purchase price of approximately \$60,600,000. The Company financed this purchase through borrowings of approximately \$47,400,000 under the Credit Facility.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Rental Property Activity (continued)

- In September 2008, Aviv Financing I acquired a property in Illinois from an unrelated third party for a purchase price of approximately \$6,200,000. The Company financed this purchase through borrowings of approximately \$5,571,000 via the assumption of HUD debt.
- In November 2008, Aviv Financing I acquired four properties in Arkansas from an unrelated third party for a purchase price of approximately \$19,617,500. The Company financed this purchase through borrowings of approximately \$15,694,000 under the Credit Facility.
- In December 2008, Aviv Financing I acquired two properties, in two separate transactions, in Kansas and California from an unrelated third party for a purchase price of approximately \$3,350,000. The Company financed this purchase through borrowings of approximately \$2,680,000 under the Credit Facility.

In accordance with ASC 805, the Company allocated the approximate net purchase price plus any related closing costs of these properties acquired in 2008 as follows:

Land	\$ 12,719,000
Buildings and improvements	80,325,000
Assets under direct financing leases	10,390,000
Mortgage and other notes payable assumed	<u>(5,571,000)</u>
Borrowings and issuances of Class E Units	<u>\$ 97,863,000</u>

The Company considers renewals on below-market leases when ascribing value to the in-place lease intangible liabilities at the date of a property acquisition. In those instances where the renewal lease rate pursuant to the terms of the lease does not adjust to a current market rent, the Company evaluates whether the stated renewal rate is below current market rates and considers the past and current operations of the property, the current rent coverage ratio of the tenant, and the number of years until potential renewal option exercise. If renewal is considered probable based on these factors, an additional lease intangible liability is recorded at acquisition and amortized over the renewal period.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Deferred Finance Costs

The following summarizes the Company's deferred finance costs at December 31, 2010 and 2009:

	2010	2009
Gross amount	\$ 10,567,931	\$ 2,620,295
Accumulated amortization	(610,295)	(1,630,637)
Net	<u>\$ 9,957,636</u>	<u>\$ 989,658</u>

Amortization of deferred financing costs is reported in the amortization expense line item in the consolidated statements of operations.

The estimated annual amortization of the deferred finance costs for each of the five succeeding years is as follows:

2011	\$ 2,116,711
2012	2,116,711
2013	2,116,021
2014	2,108,699
2015	1,499,494
Total	<u>\$ 9,957,636</u>

5. Loan Receivables

The following summarizes the Company's loan receivables at December 31, 2010 and 2009:

	2010	2009
Beginning balance	\$ 28,970,129	\$ 20,360,601
New capital improvement loans issued	1,415,579	2,816,733
Working capital and other loans issued	14,705,259	7,963,189
Reserve for uncollectible loans	(750,000)	-
Loan amortization and repayments	(7,730,329)	(2,170,394)
	<u>\$ 36,610,638</u>	<u>\$ 28,970,129</u>

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Loan Receivables (continued)

During 2010 and 2009, the Company funded loans for both working capital and capital improvement purposes to various operators and tenants. All loans held by the Company accrue interest. The payments received from the operator or tenant cover both interest accrued as well as amortization of the principal balance due. Any payments received from the tenant or operator made outside of the normal loan amortization schedule are considered principal prepayments and reduce the outstanding loan receivables balance.

Interest income earned on loan receivables for the years ended December 31, 2010, 2009, and 2008 was \$3,823,223, \$2,117,461, and \$909,645, respectively.

6. In-Place Lease Intangibles

The following summarizes the Company's in-place lease intangibles classified as part of other assets or other liabilities at December 31, 2010 and 2009:

	2010		2009	
	Assets	Liabilities	Assets	Liabilities
Gross amount	\$ 8,393,488	\$ 25,798,147	\$ 11,336,489	\$ 34,275,494
Accumulated amortization	<u>(3,049,093)</u>	<u>(14,049,691)</u>	<u>(3,836,456)</u>	<u>(16,690,291)</u>
Net	<u>\$ 5,344,395</u>	<u>\$ 11,748,456</u>	<u>\$ 7,500,033</u>	<u>\$ 17,585,203</u>

The estimated annual amortization expense of the identified intangibles for each of the five succeeding years and thereafter is as follows:

	Assets	Liabilities
2011	\$ 644,570	\$ 2,065,305
2012	644,570	1,953,351
2013	636,847	1,838,732
2014	461,961	923,735
2015	402,147	678,961
Thereafter	2,554,300	4,288,372
	<u>\$ 5,344,395</u>	<u>\$ 11,748,456</u>

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. In-Place Lease Intangibles (continued)

Amortization expense for the in-place lease intangible assets for the years ended December 31, 2010, 2009, and 2008 was \$743,890, \$986,871, and \$1,020,315, respectively. Accretion for the in-place lease intangible liabilities for the years ended December 31, 2010, 2009, and 2008 was \$2,468,500, \$3,084,525, and \$3,538,691, respectively.

During 2010, the Company wrote off in-place lease intangible assets of \$2,943,001 with accumulated amortization of \$1,531,253, and in-place lease intangible liabilities of \$8,477,347 with accumulated accretion of \$5,109,101, for a net recognition of \$1,956,498 in rental income from intangible amortization.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Mortgage and Other Notes Payable

The Company's mortgage and other notes payable consisted of the following:

	December 31	
	2010	2009
	<hr/>	
Mortgage (interest rate of 5.75% on December 31, 2010)	\$ 402,794,111	\$ —
Revolver (interest rate of 5.75% on December 31, 2010)	28,677,230	—
Construction loan (interest rate of 5.95% on December 31, 2010)	1,312,339	—
Acquisition loans (interest rate of 6.00% on December 31, 2010)	7,792,236	—
Term A loans (interest rate of 3.25% on December 31, 2009)	—	7,000,000
Term A loan (interest rate of 2.73% on December 31, 2009)	—	150,000,000
Term A loan (interest rate of 2.73% on December 31, 2009)	—	50,000,000
Term B loans (interest rate of 3.25% on December 31, 2009)	—	11,062,192
Term B loan (interest rate of 2.73% on December 31, 2009)	—	200,000,000
Construction loan (interest rate of 3.25% on December 31, 2009)	—	5,188,837
Construction loan (interest rate of 5.00% on December 31, 2009)	—	7,187,276
HUD-related debt (interest rates ranging from 5.23% to 7.25% on eight HUD properties)	—	29,154,033
Other loan (interest rate of 3.75% on December 31, 2009)	—	12,000,000
Acquisition loan (interest rate of 4.50% on December 31, 2009)	—	8,512,888
Total	<u>\$ 440,575,916</u>	<u>\$ 480,105,226</u>

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Mortgage and Other Notes Payable (continued)

In conjunction with the Merger, Aviv Financing I refinanced its debt by paying off all existing mortgages on September 17, 2010 in the amount of \$471,064,380 (outstanding balance at the Merger) and entering into a five-year credit agreement (the Credit Agreement) that provided a \$405 million mortgage term loan facility (the Mortgage) and a \$100 million revolver (the Revolver).

The Mortgage

Principal payments on the Mortgage are payable in monthly installments beginning on November 1, 2010. The payment schedule for the Mortgage is based upon a 25-year mortgage style amortization, as defined in the Credit Agreement. Interest rates, at the Company's option, are based upon the base rate or Eurodollar base rate (0.29% at December 31, 2010 with a 1.25% floor) plus 4.5%. The base rate, as defined in the Credit Agreement, is the rate announced from time to time by the Base Rate Bank as its "prime rate." The Base Rate Bank is Bank of America, N.A. The balance outstanding on the Term Loan as of December 31, 2010 was \$402.8 million. This loan matures in September 2015 and has two one-year extensions.

The Revolver

Under the Credit Agreement, the Company also has a \$100 million revolver. On each payment date, the Company shall pay interest only in arrears on any outstanding principal balance of the Revolver. Interest rates, at the Company's option, are based upon the base rate or Eurodollar base rate (0.29% at December 31, 2010 with a 1.25% floor) plus 4.5%. The base rate, as defined in the GE Credit Agreement, is the rate announced from time to time by the Base Rate Bank as its "prime rate." The Base Rate Bank is Bank of America, N.A. Additionally, an unused fee equal to 1% per annum of the daily unused balance on the Revolver is due monthly.

As of December 31, 2010, approximately \$28.7 million had been drawn on the Revolver. The ability to draw on the Revolver terminates in September 2013, at which time principal and interest are payable until the Revolver's maturity date in September 2015.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Mortgage and Other Notes Payable (continued)

Other Loans

On November 1, 2010, a subsidiary of Aviv Financing III entered into two acquisition loan agreements on the same terms that provided for borrowings of \$7.8 million. Principal and interest payments are due monthly beginning on December 1, 2010 through the maturity date of December 1, 2015. Interest is a fixed rate of 6.00%. These loans are collateralized by a skilled nursing facility controlled by Aviv Financing III. The balance outstanding on these loans at December 31, 2010 was approximately \$7.8 million.

On November 12, 2010, a subsidiary of Aviv Financing III entered into a construction loan agreement that provides for borrowings up to \$6.4 million. Interest-only payments at the prime rate (3.25% at December 31, 2010) plus 0.38%, or a minimum of 5.95%, are due monthly from December 1, 2010 through April 1, 2012. From May 1, 2012 through the maturity date of December 1, 2013, monthly payments of principal and interest are due based on a 20-year amortization schedule. This loan is collateralized by a skilled nursing facility controlled by Aviv Financing III. The balance outstanding on this loan at December 31, 2010 was approximately \$1.3 million.

Future annual maturities of all debt obligations for five fiscal years subsequent to December 31, 2010 are as follows:

2011	\$ 7,321,285
2012	7,717,628
2013	9,650,608
2014	9,227,220
2015	406,659,175
	<u>\$ 440,575,916</u>

8. Partnership Equity and Incentive Program

In conjunction with the formation of the Partnership, the Partnership issued 10,323,213 Class A Units and 3,294,733 Class B Units in exchange for all ownership interests of the roll-up contributed to the Partnership in 2005. The Partnership issued an additional 3,144,010 Class A Units and 1,228,372 Class B Units in 2006. The Class A Units issued as a result of the formation

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Partnership Equity and Incentive Program (continued)

of the Partnership have a par value of \$10.00 per unit, while Class A Units issued on December 29, 2006 as a result of the addition of additional properties have a par value of \$11.49 per unit. Operating distributions accrue at the rate of 10% per year for Class A Units. The Class A Units have a distribution preference, which decreases ratably after the full return of capital to the Class A Unitholders through distributions, and also have a liquidation preference and a profit interest in the event of sale, disposition, or refinancing, as defined in the Agreement of Limited Partnership (the Partnership Agreement).

Also in connection with the formation of the Partnership, the Partnership awarded Class C Unit profit interests. These Class C Units do not have a par value, and no capital was contributed in consideration for their issuance. These Class C Units were issued to the general partner of the Partnership, which is owned by two parties that have significant ownership holdings in the Partnership. When operating distributions are paid in full to the Class A Units as described above, the Class B and Class C Units receive all excess distributions, with 40% to Class B Unitholders and 60% to the Class C Unitholders, until the Class B Units receive \$3 million in any partnership year to the extent that all Class B Units have been issued per the Partnership Agreement. After reaching this threshold, the remaining distributions are allocated 100% to the Class C Unitholders.

The Class D Units represent profit interests in the Partnership, which may be granted periodically to employees of AAM. A total of 10,000 Class D Units have been authorized. A total of 8,050 and 7,800 Class D Units are outstanding at December 31, 2010 and 2009, respectively. The Class D Units are not entitled to any distributions of the Partnership, except in the event of sale, disposition, or refinancing, as defined. Class C Units also have an interest in these proceeds. The terms of the Class D Units were amended at the Merger. Part of the Class D Units are defined as performance-based awards under ASC 718 and require employment of the recipient on the date of sale, disposition, or refinancing (Liquidity Event). If the employee is no longer employed on such date, the award is forfeited. For accounting purposes, the grant date fair value will be recognized as an expense when a Liquidity Event becomes imminent and such fair value on the grant date was determined to be \$0.9 million. The remainder of the Class D Units are time-based awards under ASC 718, and such fair value determined on the grant date is recognized over the vesting period. During 2010, 3,220 of the time-based Class D Units vested, resulting in the recognition of \$888,400 in expense. No expense relating to these awards was recognized in 2009.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Partnership Equity and Incentive Program (continued)

Distributions to the Partnership's partners are summarized as follows for the years ended December 31:

	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>	<u>Class D</u>	<u>Class E</u>	<u>Class F</u>	<u>Class G</u>
2010	\$ 13,594,547	\$ 2,894,457	\$ 12,683,113	\$ –	\$ 5,342,466	\$3,792,881	\$6,092,935
2009	13,562,740	2,894,457	10,339,900	–	6,898,235	4,430,085	–
2008	13,562,740	2,774,081	4,161,121	–	4,692,899	5,223,778	–

Weighted-average units outstanding are summarized as follows for the respective years ended December 31:

	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>	<u>Class D</u>	<u>Class E</u>	<u>Class F</u>	<u>Class G</u>
2010	13,467,223	4,523,145	2	7,386	5,342,489	4,597,432	65,338
2009	13,467,223	4,523,145	2	8,033	6,901,950	5,369,800	–
2008	13,467,223	4,523,145	2	9,006	4,693,784	5,369,800	–

The Partnership had established an officer incentive program linked to its future value. Awards vest annually over a five-year period assuming continuing employment by the recipient. The awards can be settled in Class C Units or cash at the Company's discretion at the settlement date of December 31, 2012. For accounting purposes, expense recognition under the program commenced in 2008, and the related expense for the years ended December 31, 2010, 2009, and 2008 was approximately \$406,000, \$406,000, and \$406,000, respectively.

As a result of the Merger on September 17, 2010, such incentive program was modified such that 40% of the previously granted award settled immediately on the Merger date with another 20% vesting and settling on December 31, 2010. The remaining 40% will vest equally on December 31, 2011 and December 31, 2012, and will settle in 2018, subject to the terms and conditions of the amended incentive program agreement. In accordance with ASC 718, such incentive program will continue to be expensed through general and administrative expenses as non-cash compensation on the consolidated statements of operations through the ultimate vesting date of December 31, 2012.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Option Awards

On September 17, 2010, the Company adopted the Plan as part of the Merger transaction.

In connection with the Merger, 64,168 options were granted to certain members of management and advisory board members on September 17, 2010 with an exercise price of \$1,000 per option. Two-thirds of the options granted, or 42,778 shares, are performance-based awards whose criteria for vesting is tied to a future Liquidity Event (as defined) and also contingent upon meeting certain return thresholds (as defined). At this time, the Company does not believe it is probable that these options will vest and therefore has not recorded any expense in the December 31, 2010 consolidated financial statements in accordance with ASC 718. The grant date fair value associated with all performance-based award options of the Company aggregates approximately \$4.0 million as of December 31, 2010. One-third, or 21,390 shares, of the options granted were time-based awards, and the service period for these options is four years with shares vesting at a rate of 25% on September 17, 2010, 2011, 2012, and 2013.

An additional 1,425 options were granted to certain members of management and advisory board members on September 30, 2010 with an exercise price of \$1,084 per option. Two-thirds of the options granted, or 949 shares, are performance-based awards (as defined above). One-third, or 476 shares, of the options granted were time-based awards (as defined above). The grant date fair value of each time-based award is charged to non-cash compensation expense on a graded basis over the vesting period. No option awards were granted prior to September 17, 2010. The following table represents the time-based option awards activity for the year ended December 31, 2010.

Outstanding at beginning of period	–
Granted	21,866
Exercised	–
Canceled/forfeited	–
Outstanding at end of period	21,866
Options exercisable at end of period	–
Weighted-average fair value of options granted	\$ 108.55
Weighted-average remaining contractual life	9.72

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Option Awards (continued)

The following table represents the time-based option awards outstanding for the year ended December 31, 2010, as well as other Plan data:

Range of Exercise Prices	Outstanding	Remaining Contractual Life (Years)	Weighted- Average Exercise Price
\$1,000 – \$1,084	21,866	9.72	\$ 1,002

The Company has used the Black-Scholes option pricing model to estimate the grant date fair value of the options. The following table includes the assumptions that were made in estimating the grant date fair value for options awarded in 2010.

	<u>2010 Grants</u>
Dividend yield	10.28%
Risk-free interest rate	2.1%
Expected life	7.0 years
Estimated volatility	38.00%
Weighted-average exercise price	\$1,001.83
Weighted-average fair value of options granted (per option)	\$108.55

The Company recorded non-cash compensation expenses of \$337,598 for the year ended December 31, 2010, related to the time-based stock options accounted for as equity awards, as a component of general and administrative expenses in the consolidated statements of operations.

At December 31, 2010, the total compensation cost related to outstanding, non-vested, time-based equity option awards that are expected to be recognized as compensation cost in the future aggregates approximately \$2,036,000.

For the year ended December 31:	
2011	\$ 1,056,730
2012	572,691
2013	298,647
2014	107,809
Total	<u><u>\$ 2,035,877</u></u>

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Option Awards (continued)

Dividend equivalent rights associated with the Plan amounted to \$586,630 for the year ended December 31, 2010, which were incurred during the fourth quarter of 2010, and are included in general and administrative expense in the consolidated statements of operations. These dividend rights will be paid in four installments as the option vests.

10. Minimum Future Rentals

The Company's rental properties are leased under noncancelable, triple-net operating leases. Under the provisions of the leases, the Company receives fixed minimum monthly rentals, generally with annual increases, and the tenants are responsible for the payment of all operating expenses, including repairs and maintenance, insurance, and real estate taxes of the property throughout the term of the leases.

At December 31, 2010, future minimum annual rentals to be received under the noncancelable lease terms are as follows:

2011	\$ 84,992,545
2012	88,174,683
2013	90,498,508
2014	88,768,851
2015	88,841,343
Thereafter	<u>473,832,636</u>
	<u>\$ 915,108,566</u>

11. Related Parties

Related-party receivables and payables represent amounts due from/to various affiliates of the Company, including advances to members of the Company, amounts due to certain acquired companies and limited liability companies for transactions occurring prior to the formation of the Company, and various advances to entities controlled by affiliates of the Company's management.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Related Parties (continued)

The Partnership had entered into a management agreement, as amended, effective April 1, 2005, with AAM, an entity affiliated by common ownership. Under the management agreement, AAM had been granted the exclusive right to oversee the portfolio of the Partnership, providing, among other administrative services, accounting and all required financial services; legal administration and regulatory compliance; investor, tenant, and lender relationship services; and transactional support to the Partnership. Except as otherwise provided in the Partnership Agreement, all management powers of the business and affairs of the Partnership are exclusively vested in the general partner. The annual fee for such services equals six-tenths of one percent (0.6%) of the aggregate fair market value of the properties as determined by the Partnership and AAM annually. This fee arrangement was amended as discussed below. In addition, the Partnership reimbursed AAM for all reasonable and necessary out-of-pocket expenses incurred in AAM's conduct of its business, including, but not limited to, travel, legal, appraisal, and brokerage fees; fees and expenses incurred in connection with the acquisition, disposition, or refinancing of any property; and reimbursement of compensation and benefits of the officers and employees of AAM. This agreement was terminated on September 17, 2010 when the Merger occurred, effectively consolidating AAM into the Company and eliminating the necessity for reimbursement.

On October 16, 2007, the Company legally acquired AAM through a Manager Contribution and Exchange Agreement dated October 16, 2007 (the Contribution Agreement). As stipulated in the Contribution Agreement and the Second Amended and Restated Agreement of Limited Company on October 16, 2007 (the Partnership Agreement), the Company issued a new class of Company Unit, Class F Units, as consideration to the contributing members of AAM. The contributing members of AAM served as the general partner of the Partnership. The Class F Units have subordinated payment and liquidity preference to the Class E Units but are senior in payment and liquidity preference, where applicable, to the Class A, B, C, and D Units of the Partnership. The Class F Units paid in quarterly installments an annual dividend of 8.25% of the preliminary face amount of \$53,698,000. The preliminary pricing was based upon trading multiples of comparably sized, publicly traded healthcare REITs. The ultimate Class F Unit valuation was subject to a true-up formula at the time of a Liquidity Event, as defined in the Partnership Agreement.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Related Parties (continued)

For accounting purposes, prior to the Merger, AAM had not been consolidated by the Company nor had any value been ascribed to the Class F Units issued due to the ability of the Class E Unitholders to unwind the acquisition as described above. Such action was outside the control of the Company, and accordingly, the acquisition is not viewed as having been consummated. The dividends earned by the Class F Unitholders were reflected as a component of management fees as described above. Subsequent to October 16, 2007, the fee for management services to the Company is equal to the dividend earned on the Class F Units and was reported as management fee expense.

Under certain circumstances, the Partnership Agreement did permit the Class E Unitholders to unwind this transaction and requires the Company to redeem the Class F Units by returning to the affiliates all membership interests in AAM. On September 17, 2010, the Company settled the investment with JER Aviv Acquisition, LLC (JER). For accounting purposes, this treatment triggered the retroactive consolidation of AAM by the Company. The original and follow-on investments of Class E Unitholders were made subject to the Unit Purchase Agreement and related documents (the UPA) between the Company and JER dated May 26, 2006.

The UPA did not give either party the right to settle the investment prior to May 26, 2011. However, the UPA did have an economic arrangement as to how either party could settle the arrangement on or after that date. This economic construct guided the discussions and negotiations of settlement. The UPA allowed the Company to call the Class E Units and warrants anytime after May 26, 2011, as long as it provided JER with a 15% internal rate of return (IRR) from the date of inception. The IRR would be calculated factoring interim distributions as well as exit payments. The units were settled for \$92,001,451 contemporaneous with the Merger. A portion of the settlement related to outstanding warrants held by JER and originally issued in connection with the Class E Units issuance.

Coincident with the Merger, 50% of the Class F Units was purchased and settled by the Company for \$23,602,649 and is reported as a component of distributions to partners and accretion on Class E Preferred Units in the consolidated statements of changes in equity. The remaining Class F Units will pay in quarterly installments an annual dividend of 9.38% of the face amount of \$23,602,649.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Derivatives

During the periods presented, the Company was party to various interest rate swaps, which were purchased to fix the variable interest rate on the denoted notional amount under the original debt agreements.

At December 31, 2009, the Company was party to the following interest rate swaps, which were purchased to fix the variable interest rate on the denoted notional amount under the original and amended credit agreements and on the acquisition loan, which was obtained in April 2009:

Total notional amount	\$289,976,000
Fixed interest rates range	1.54% – 5.20%
Effective date range	April 18, 2005 – July 17, 2009
Termination date range	February 26, 2010 – September 16, 2011
Asset balance at December 31, 2009 (included in other assets)	\$ –
Liability balance at December 31, 2009 (included in other liabilities)	\$6,311,470

On September 17, 2010, in connection with the extinguishment of the original credit facility, the Company settled all related interest rate swaps at a fair value of \$3,380,160.

At December 31, 2010, the Company is party to two interest rate swaps with identical terms for \$100 million each. They were purchased to fix the variable interest rate on the denoted notional amount under the Mortgage that was obtained in September 2010 and qualify for hedge accounting. For presentational purposes, they are shown as one derivative due to the identical nature of their economic terms.

Total notional amount	\$200,000,000
Fixed rates	6.49% (1.99% effective swap base rate plus 4.5% spread per credit agreement)
Floor rate	1.25%
Effective date	November 9, 2010
Termination date	September 17, 2015
Asset balance at December 31, 2010 (included in other assets)	\$4,094,432
Liability balance at December 31, 2010 (included in other liabilities)	\$ –

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Derivatives (continued)

The fair value of each interest rate swap agreement may increase or decrease due to changes in market conditions but will ultimately decrease to zero over the term of each respective agreement.

For the years ended December 31, 2010, 2009, and 2008, the Company recognized approximately \$2.9 million and \$7.0 million of net income and recognized approximately \$8.7 million of net expense, respectively, in the consolidated statements of operations related to the change in the fair value of interest rate swap agreements where the Company did not elect to apply hedge accounting.

The following table provides the Company's derivative assets and liabilities carried at fair value as measured on a recurring basis as of December 31, 2010 (dollars in thousands):

	Total Carrying Value at December 31 2010	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative assets	\$ 4,094	\$ –	\$ 4,094	\$ –
Derivative liabilities	–	–	–	–
	<u>\$ 4,094</u>	<u>\$ –</u>	<u>\$ 4,094</u>	<u>\$ –</u>

The Company's derivative assets and liabilities include interest rate swaps that effectively convert a portion of the Company's variable rate debt to fixed rate debt. The 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.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Commitments and Contingencies

The Company has a contractual arrangement with a tenant to reimburse quality assurance fees levied by the California Department of Health Care Services from August 1, 2005 through July 31, 2008. The Company is obligated to reimburse the fees to the tenant if and when the state withholds these fees from the tenant's Medi-Cal reimbursements associated with five facilities that were formerly leased to Trinity Health Systems. The total possible obligation for these fees is \$1,655,286, of which approximately \$1,000,000 has been paid to date. For the year ended December 31, 2010, the Company's indemnity expense for these fees was \$1,003,000, which equaled the actual amount paid during the period.

Judicial proceedings seeking declaratory relief for these fees are in process that, if successful, would provide for recovery of such amounts from the State of California. The Company has certain rights to seek relief against Trinity Health Systems for monies paid out under the indemnity claim; however, it is uncertain whether the Company will be successful in receiving any amounts from Trinity Health Systems.

In the normal course of business, the Company is involved in legal actions arising from the ownership of its property. In management's opinion, the liabilities, if any, that may ultimately result from such legal actions are not expected to have a material adverse effect on the consolidated financial position, operations, or liquidity of the Company.

14. Concentration of Credit Risk

As of December 31, 2010, the Company's portfolio of investments consisted of 181 healthcare facilities, located in 24 states and operated by 32 third-party operators. At December 31, 2010, approximately 50.7% (measured as a percentage of total assets) was leased by five private operators: Evergreen Healthcare (13.6%), Daybreak Healthcare (12.4%), Sun Mar Healthcare (9.0%), HiCare (8.1%), and Convacare (7.6%). No other operator represents more than 6.3% of the Company's total assets. The five states in which the Company had its highest concentration of total assets were California (19.3%), Texas (16.3%), Missouri (9.6%), Arkansas (8.0%), and Pennsylvania (6.1%) at December 31, 2010.

For the year ended December 31, 2010, the Company's rental income from operations totaled approximately \$84.5 million, of which approximately \$11.6 million was from Evergreen Healthcare (13.7%), \$9.1 million was from Daybreak Healthcare (10.7%), and \$9.1 million was from Sun Mar Healthcare (10.7%). No other operator generated more than 8.3% of the Company's rental income from operations for the year ended December 31, 2010.

Aviv REIT, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Subsequent Events

On January 4, 2011, Aviv Financing I acquired a property in Kansas from an unrelated third party for a purchase price of \$3,045,000. The Company financed this purchase through borrowings of \$2,131,000 under the Mortgage (as described in Note 7).

On February 4, 2011, the Company issued \$200 million in Senior Notes at 7.75%. The proceeds from this bond issuance were used to pay down \$194 million of the Mortgage.

On March 1, 2011, the Company replaced an operator of three buildings in Pennsylvania and one in Massachusetts from the operator Brighten to the operator Saber. The Company anticipates that it will recognize a charge to write off a deferred rent receivable balance relating to the terminated lease of approximately \$2.4 million in the first quarter of 2011.

The Company has evaluated events subsequent to December 31, 2010 through March 15, 2011, and determined that no events other than those noted above would require additional disclosure.

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