

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The information presented herein includes forward-looking statements. Forward-looking statements provide our current expectations or forecasts of future events. Forward-looking statements include statements about our expectations, beliefs, intentions, plans, objectives, goals, strategies, future events, performance and underlying assumptions and other statements that are not historical facts. Examples of forward-looking statements include all statements regarding our expected future financial position, results of operations, cash flows, liquidity, financing plans, business strategy, projected growth opportunities and potential acquisitions, plans and objectives of management for future operations, and compliance with and changes in governmental regulations. You can identify forward-looking statements by their use of forward-looking words, such as “may,” “will,” “anticipates,” “expect,” “believe,” “estimate,” “intend,” “plan,” “should,” “seek” or comparable terms, or the negative use of those words, but the absence of these words does not necessarily mean that a statement is not forward-looking.

These forward-looking statements are made based on our current expectations and beliefs concerning future events affecting us and are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed in or implied by these forward-looking statements. Important factors that could cause actual results to differ materially from our expectations include those disclosed under “Risk Factors” and elsewhere in filings made by Aviv Healthcare Properties Limited Partnership with the Securities and Exchange Commission. There may be additional risks of which we are presently unaware or that we currently deem immaterial. Forward-looking statements are not guarantees of future performance. We do not undertake any responsibility to release publicly any revisions to these forward-looking statements to take into account events or circumstances that occur after the date as of which such statements are made or to update you on the occurrence of any unanticipated events which may cause actual results to differ from those expressed or implied by the forward-looking statements contained in the information presented herein.

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this quarterly report elsewhere herein.

### **Overview**

We operate a self-administered real estate investment trust, or REIT, that focuses on the ownership of healthcare properties, principally skilled nursing facilities (“SNFs”). We generate our revenues through long-term triple-net leases with a diversified group of high quality operators throughout the United States. Through our predecessor entities, we have been in the business of financing operators of SNFs for over 30 years. We believe that we have one of the largest SNF portfolios in the United States which consisted of 187 properties, of which 168 were SNFs, with 18,300 licensed beds in 25 states leased to 32 operators as of March 31, 2011. The discussion included herein is meant for Aviv REIT, Inc. and Subsidiaries and Aviv Healthcare Properties Limited Partnership and Subsidiaries as the operations of the two aforementioned entities are materially comparable for the periods presented.

We believe we are well positioned to benefit from our diversified portfolio of properties and extensive network of operator relationships. We focus on cultivating close relationships with our tenants by working closely with them to help them achieve their business objectives. As a result of these efforts,

we are in a position to effectively manage our portfolio, make additional investments and continue to expand our business.

We lease our properties to a diversified group of 32 operators with no single operator representing more than 15.1% of our revenues for the three months ended March 31, 2011. We have a geographically diversified portfolio of properties located in 25 states, with no state representing more than 21.4% of our revenues for the three months ended March 31, 2011. Our properties are leased to third party tenants under long-term triple-net leases. The operators are responsible for all operating costs and expenses related to the property, including facility maintenance and insurance required in connection with the properties and the business conducted on the properties, taxes levied on or with respect to the properties (other than taxes on our income) and all utilities and other services necessary or appropriate for the properties and the business conducted on the properties. Our leases are typically master leases with initial terms of 10 years or more, annual rent escalation provisions of 2% to 3%, guarantees, cross-default provisions and security deposits and typically do not have operator purchase options. As of March 31, 2011, the leases for 185 of our 187 properties were supported by personal and/or corporate guarantees. As of March 31, 2011, our leases had an average remaining term of 8.8 years.

We have historically financed investments through borrowings under our credit facilities, private placements of equity securities, housing and urban development indebtedness, or a combination of these methods. We have utilized a mortgage credit facility and senior notes to provide the majority of our debt as well as project specific first mortgages in certain situations. We compete with other public and private companies who provide lease and/or mortgage financing to operators of a variety of different types of healthcare properties. While the overall landscape for healthcare finance is competitive, we are disciplined and selective about the investments we make and have a strong track record of identifying qualified operators and attractive markets in which to invest. As a key part of our growth strategy, we evaluate acquisition opportunities on an ongoing basis and are in various stages of due diligence, preliminary discussions or competitive bidding with respect to a number of potential transactions, some of which would be significant. None of these potential significant transactions is subject to a letter of intent or otherwise so far advanced as to make the transaction reasonably certain.

## **Factors Affecting Our Business and the Business of Our Tenants**

The continued success of our business is dependent on a number of macroeconomic and industry trends. Many of these trends will influence our ongoing ability to find suitable investment properties while other factors will impact our tenants' ability to conduct their operations profitably and meet their obligations to us.

### *Industry Trends*

One of the primary trends affecting our business is the long-term increase in the average age of the U.S. population. This increase in life expectancy is expected to be a primary driver for growth in the healthcare and SNF industry. We believe this demographic trend is resulting in an increased demand for services provided to the elderly. We believe that the low cost healthcare setting of a SNF will benefit our tenants and facilities in relation to higher-cost healthcare providers. We believe that these trends will support a growing demand for the services provided by SNF operators, which in turn will support a growing demand for our properties.

The growth in demand for services provided to the elderly has resulted in an increase in healthcare spending. The Centers for Medicare and Medicaid Services, or CMS, and the Office of the

Actuary forecast that U.S. healthcare expenditures will increase from approximately \$2.3 trillion in 2008 to approximately \$4.5 trillion in 2019. Furthermore, according to CMS, national expenditures for SNFs are expected to grow from approximately \$144 billion in 2009 to approximately \$246 billion in 2019, representing a compound annual growth rate, or CAGR, of 5.5%.

#### *Liquidity and Access to Capital*

Our single largest cost is the interest expense we incur on our debt obligations. In order to continue to expand and optimize our capital to expand our portfolio, we rely on access to the capital markets on an ongoing basis. We seek to balance this reliance by maintaining ready access to funds to make investments at the time opportunities arise. We have extensive experience in and a successful track record of raising debt and equity capital over the past 30 years.

Our indebtedness outstanding is comprised principally of term loans secured by first mortgages, unsecured obligations under the Senior Notes and borrowings under our existing secured credit facilities.

Substantially all of such indebtedness is scheduled to mature in late 2015 or thereafter.

#### *Factors Affecting Our Tenants' Profitability*

Our revenues are derived from rents we receive from triple-net leases with our tenants. Certain economic factors present both opportunities and risks to our tenants and, therefore, influence their ability to meet their obligations to us. These factors directly affect our tenants' operations and, given our reliance on their performance under our leases, present risks to us that may affect our results of operations or ability to meet our financial obligations. The recent U.S. economic slowdown and other factors could result in cost-cutting at both the federal and state levels, which could result in a reduction of reimbursement rates and levels to our tenants under both the Medicare and Medicaid programs.

Our tenants' revenues are largely derived from third-party sources. Therefore, we indirectly rely on these same third-party sources to obtain our rents. The majority of these third-party payments come from the federal Medicare program and state Medicaid programs. Our tenants also receive payments from other third-party sources, such as private insurance companies or private-pay residents, but these payments typically represent a small portion of our tenants' revenues. The sources and amounts of our tenants' revenues are determined by a number of factors, including licensed bed capacity, occupancy rates, the acuity profile of residents and the rate of reimbursement. Changes in the acuity profile of the residents as well as the mix among payor types, including private pay, Medicare and Medicaid, may significantly affect our tenants' profitability and, in turn, their ability to meet their obligations to us. Managing, billing and successfully collecting third-party payments is a relatively complex activity that requires significant experience and is critical to the successful operation of a SNF.

Labor and related expenses typically represent our tenants' largest cost component. Therefore, the labor markets in which our tenants operate affect their ability to operate cost effectively and profitably. In order for our tenants to be successful, they must possess the management capability to attract and maintain skilled and motivated workforces. Much of the required labor needed to operate a SNF requires specific technical experience and education. As a result, our tenants may be required to increase their payroll costs to attract labor and adequately staff their operations. Increases in labor costs due to higher wages and greater employee benefits required to attract and retain qualified personnel could affect our tenants' ability to meet their obligations to us.

While our revenues are generated from the rents our tenants pay to us, we seek to establish our rent at an appropriate level so that our tenants are able to succeed. This requires discipline to ensure that

we do not overpay for the properties we acquire. While we operate in a competitive environment, we carefully assess the long-term risks facing our tenants as we consider an investment. Because our leases are long-term arrangements, we are required to assess both the short and long-term capital needs of the properties we acquire. SNFs are generally highly specialized real estate assets. We believe we have developed broad expertise in assessing the short and long-term needs of this asset class.

## **Components of Our Revenues, Expenses and Cash Flow**

### *Revenues*

Our revenues consist primarily of the rents and associated charges we collect from our tenants as stipulated in our long-term triple-net leases. In addition to rent under existing leases, a part of our revenues is made up of other cash payments owed to us by our tenants. Additionally, we recognize certain non-cash revenues. These other cash and non-cash revenues are highlighted below. While not a significant part of our revenues, we also earn interest from a variety of loans outstanding.

- *Rental Income*

Rental income represents rent under existing leases that is paid by our tenants. In addition, this includes deferred rental income relating to straight-lining of rents as well as rental income from intangible amortization. Both deferred rental income and rental income from intangible amortization are explained in further detail below under “—Components of Cash Flow—Cash Provided by Operations.”

- *Tenant Recoveries*

All of our leases have real estate escrow clauses that require our tenants to make estimated payments to us to cover their current real estate tax obligations. We collect money for these taxes and pay them on behalf of our tenants. We account for the receipt of these amounts as revenue and the payment of the actual taxes as an expense (real estate taxes). Because the escrow charges to our tenants are made on an estimated basis, the amounts recognized as revenue and corresponding expense will differ slightly in any given fiscal period.

- *Interest on Loans to Lessees*

We earn interest on certain capital advances and loans we make to our tenants for a variety of purposes, including for capital expenditures at our properties for which we receive additional rent. While we amend our leases to reflect the additional rent owed as a result of these income producing capital expenditures, we recognize the investment as a loan for accounting purposes when the lease term exceeds the useful life of the capital expenditure. In addition, we recognize rent associated with direct financing leases, in part, as interest income.

### *Expenses*

We recognize a variety of cash and non-cash charges in our financial statements. Our cash expenses consist primarily of the interest expense on the borrowings we incur in order to make our investments and the general and administrative costs associated with operating our business. These interest charges are associated with both our existing credit facilities as well as certain asset specific loans.

- *Rent and Other Operating Expenses*

When we lease a property, we recognize related rent expense.

- *General and Administrative*

Our general and administrative costs consist primarily of payroll and payroll related expense, including non-cash stock based compensation. In addition to payroll, we incur accounting, legal and other professional fees as well as certain other administrative costs of running our business, along with certain expenses related to bank charges, franchise taxes and corporate filing fees.

- *Real Estate Taxes*

All of our leases have real estate escrow clauses that require our tenants to make estimated payments to us to cover their current real estate tax obligations. We collect money for these taxes and pay them on behalf of our tenants. We account for the receipt of these amounts as revenue (tenant recoveries) and the payment of the actual taxes as an expense. Because the escrow charges to our tenants are made on an estimated basis, the amounts recognized as revenue and corresponding expense will differ slightly in any given fiscal period.

- *Depreciation*

We incur depreciation expense on all of our long-lived assets. This non-cash expense is designed under generally accepted accounting principles, or GAAP, to reflect the economic useful lives of our assets.

- *Loss on Impairment of Assets*

We have implemented a policy that requires management to make quarterly assessments of the market value of our properties relative to the amounts at which we carry them on our balance sheet. This assessment requires a combination of factors. We utilize objective financial modeling that compares the sum of the undiscounted cashflows from future contractual rents plus the terminal value against the depreciated book value of an asset. In addition, certain subjective factors such as market condition and property condition are considered as well as well as lease structure. We consider these results in our assessment of whether potential impairment indicators are present.

#### *Other Income and Expenses*

- *Interest and Other Income*

We sweep our excess cash balances into overnight interest-bearing accounts.

- *Interest Expense*

We recognize the interest we incur on our existing borrowings as an interest expense.

- *Change in Fair Value of Derivatives*

We have implemented Accounting Standards Codification (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. All of the changes in the fair market values of our derivative instruments are recorded in the consolidated statements of operations for our interest rate swaps that were terminated in September 2010. In November 2010, we entered into two interest rate swaps and account for changes in fair value of such hedges through changes in equity in our financial statements via hedge accounting.

- *Amortization of Deferred Financing Costs*

We incur non-cash charges that reflect costs incurred with arranging certain debt instruments. We generally recognize these costs over the term of the respective debt instrument for which the costs were incurred.

- *Loss on Extinguishment of Debt*

We recognize costs relating to extinguishing debt prior to initial termination dates when we incur them.

### *Components of Cash Flow*

#### *Cash Provided by Operations*

Cash provided by operations is derived largely from net income by adjusting our revenues for those amounts not collected in cash during the period in which the revenue is recognized and for cash collected that was billed in prior periods or will be billed in future periods. Net income is further adjusted by adding back expenses charged in the period that is not paid for in cash during the same period. We make our distributions based largely on cash provided by operations. Key non-cash add-backs, in addition to depreciation and the amortization of deferred financing charges, in deriving cash provided by operations are:

*Deferred Rental Income.* We recognize deferred rental income as a result of the accounting treatment of many of our long-term leases that include fixed rent escalation clauses. Because most of our leases contain fixed rent escalations, we "straight-line" our lease revenue recognition. Straight-lining involves spreading the rents we expect to earn during the term of a lease under its escalation clause over the lease term. As a result, during the first half of a lease term with a fixed escalation clause, we accrue a receivable for rents owed but not paid until future periods. During the second half of the lease term, our cash receipts exceed our recognized revenues and we amortize the receivable.

*Rental Income from Intangible Amortization.* We incur non-cash rental income adjustments from the amortization of certain intangibles resulting from the required application of purchase accounting in the initial recording of our real estate acquisitions. At the date of acquisition, all assets acquired and liabilities assumed are recorded at their respective fair value, including any value attributable to in-place lease agreements. Any identified above or below market lease intangible asset or liability is amortized over the remaining lease term as a non-cash adjustment to rental income.

*Non-cash stock-based compensation.* We incur non-cash expense associated with the share-based payments to certain employees. The share-based payments are in the form of stock options. Expense is recognized ratably with the vesting schedule based on the grant date fair value of the options.

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The Partnership follows ASC 718, 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 Partnership for awards granted under the Plan.

The Partnership had established an officer incentive program linked to its future value. These 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 Partnership'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 three months ended March 31, 2011 and 2010 was approximately \$101,500 and \$101,500, 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, *Compensation – Stock Compensation* (ASC 718), such incentive program will continue to be expensed through general and administrative expenses as non-cash compensation on the statements of operations through the ultimate vesting date of December 31, 2012.

On September 17, 2010, the Company adopted a 2010 Management Incentive Plan (the “Plan”) as part of the Merger transaction.

The following table represents the time based option awards activity for the three months ended March 31, 2011.

	<u>March 31, 2011</u>
Outstanding at beginning of period	21,866
Granted	456
Exercised	-
Cancelled/Forfeited	-
Outstanding at end of period	<u>22,322</u>
Options exercisable at end of period	<u>-</u>
Weighted average fair value of options granted	<u>\$ 149.09</u>
Weighted average remaining contractual life	<u>9.48</u>

The following table represents the time based option awards outstanding for at March 31, 2011 as well as other Plan data:

<b>Range of exercise prices</b>	<b>Outstanding</b>	<b>Remaining Contractual Life (Years)</b>	<b>Weighted Average Exercise Price</b>
\$1,000 – \$1,124	22,322	9.48	\$1,004

The Partnership 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 2011.

	<b>2011 Grants</b>
Dividend yield	9.16%
Risk-free interest rate	2.72%
Expected life	7.0 years
Estimated volatility	38.00%
Weighted average exercise price	\$1,124.22
Weighted average fair value of options granted (per option)	\$149.09

The Partnership recorded non-cash compensation expenses of \$299,468 for the three months ended March 31, 2011, 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 March 31, 2011, 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 to approximately \$1,804,000.

<b>For the period ended December 31,</b>	<b>Options</b>
2011	\$791,093
2012	591,886
2013	309,028
2014	112,338
2015	48
Total	<b>\$1,804,393</b>

Dividend equivalent rights associated with the Plan amounted to \$535,728 for the three months ended March 31, 2011, 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.

*Non-cash loss on extinguishment of debt.* We incurred certain expense associated with the partial pre-payment of our secured mortgage term loan. Costs associated with the origination of this loan were capitalized and being ratably expensed over the life of the loan. When we pre-paid this loan in part, we recognized a prorated non-cash expense write-off for the unamortized capitalized debt costs.

*Reserve for uncollected rental income and uncollectable loan receivable.* We incur an expense estimate for a reserve based upon our historical collection record of billed rental income and collections of loan receivables.

#### *Cash Used in Investing Activities*

Cash used in investing activities consists of cash that is used during a period for making new investments, capital expenditures and tenant loans.

#### *Cash Provided by Financing Activities*

Cash provided by financing activities consists of cash we received from issuances of debt and equity capital. This cash provides the primary basis for the investments in new properties, capital expenditures and tenant loans. While we invest a portion of our cash from operations into new investments, as a result of our distribution requirements to maintain our REIT status, it is likely that additional debt or equity issuances will finance the majority of our investment activity.

## **Results of Operations**

The following is a discussion of the consolidated results of operations, financial position and liquidity and capital resources of Aviv Healthcare Properties Limited Partnership.

### *Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010*

#### *Revenues*

Revenues decreased \$1.1 million, or 4.6%, from \$23.8 million for the three months ended March 31, 2010 to \$22.7 million for the same period in 2011. The \$1.1 million decrease was the result of an increase in rental revenue of \$671,000, off-set by a write-off (expense) of deferred rent receivable of \$2.2 million due to the termination of a lease and replacement of an operator. Interest on loans to lessees also increased by \$201,000 as a result of interest earned on loans we made at our properties.

Detailed changes in revenues for the three months ended March 31, 2011 compared to the same period in 2010 were as follows:

- Rental income decreased \$1.5 million, or 6.9%, from \$21.2 million for the three months ended March 31, 2010 to \$19.7 million for the same period in 2011. The \$1.5 million decrease was the result of an increase in rental revenue of \$671,000 that resulted from additional rent associated with \$109 million of acquisitions and investments made in the twelve months ending March 31, 2011, off-set by a write-off (expense) of deferred rent receivable of \$2.2 due to the termination of a lease and replacement of an operator.
- Tenant recoveries increased \$160,000, or 10.5%, from \$1.5 million for the three months ended March 31, 2010 to \$1.7 million for the same period in 2011. The increase was a result of the additional tenant recoveries associated with real estate taxes for newly acquired facilities included in the \$109 million of acquisitions and investments made in the twelve months ended March 31, 2011 as well as the tenant recoveries from those investments made in the three months ended March 31, 2010 that were not owned for the entire 2010 period. The increase was also due to an increase in tenant recoveries related to increases in real estate taxes from investments held more than one year.
- Interest on loans to tenants increased \$201,000, or 26.2%, from \$1.1 million for the three months ended March 31, 2010 to \$1.3 million for the same period in 2011. Most of this increase in the 2011 period was a result of loans to tenants to make capital expenditures that they made in our properties for which we receive interest.

#### *Expenses*

Expenses increased \$2.6 million, or 34.3%, from \$7.6 million for the three months ended March 31, 2010 to \$10.2 million for the same period in 2011. This increase was primarily due to an increase in

general and administrative expenses of \$2.0 million which was attributable to \$1.0 million of non-cash share-based compensation expense in 2011 and also an increase in professional fees of \$670,000 because of a \$430,000 write off of legal expenses that were recovered from a tenant in the three months ended March 31, 2010.

Detailed changes in expenses for the three months ended March 31, 2011 compared to the same period in 2010 were as follows:

- Rent and other operating expenses were comparable period over period.
- General and administrative expense increased \$2.0 million, or 143.5%, from \$1.4 million for the three months ended March 31, 2010 to \$3.5 million for the same period in 2011. The increase was primarily due to \$1.0 million of non-cash share-based compensation expense in 2011 and also an increase in professional fees of \$670,000 due to a \$430,000 write off of legal expenses in the first quarter of 2010. These legal fees were expensed in 2009 but were recovered from the tenant in the first quarter of 2010.
- Real estate tax expense was comparable period over period. Although we had an increase associated with the \$109 million in acquisitions for the twelve months ended March 31, 2011, these increases were offset by property tax decreases and three property dispositions in 2010.
- Depreciation expense increased \$437,000, or 10.0%, from \$4.4 million for the three months ended March 31, 2010 to \$4.8 million for the same period in 2011. The increase was a result of an increase in depreciation expense associated with 13 newly acquired facilities included in the \$109 million of acquisitions and investments made during the twelve months ended March 31, 2011.

#### *Other Income and Expenses*

- Interest and other income decreased \$58,000 or 91.1%, from \$63,000 for the three months ended March 31, 2010 to \$6,000 for the same period in 2011. Most of this decrease was a result of a decrease in average cash balances.
- Interest expense increased \$1.7 million, or 28.8%, from \$5.9 million for the three months ended March 31, 2010 to \$7.6 million for the same period in 2011. The majority of the increase was due to an increase in the interest rate on our debt associated with our credit facilities and senior notes offset by a lesser amount of debt outstanding in the three months ended March 31, 2011 as compared to the same period in 2010.
- Income relating to the change in fair value of derivatives decreased \$1.3 million, or 100%, from a gain of \$1.3 million in the three months ended March 31, 2010 to \$0 in the same period in 2011. We settled our existing swaps in September 2010 as part of our debt refinancing. We entered into new swap arrangements in November 2010 and these swaps have been deemed to be eligible for hedge accounting, such changes are reported in accumulated other comprehensive income within the consolidated statement of changes in equity, exclusive of ineffectiveness amounts, which are recognized as adjustments to net income.
- Amortization of deferred financing fees increased \$540,000, or 387.5%, from \$139,000 for the three months ended March 31, 2010 to \$679,000 for the same period in 2011. The increase was due to additional fees incurred in conjunction with our new \$405 million mortgage term loan

entered into in September 2010 and our \$200 million issuance of Senior Notes in February of 2011.

- Loss on extinguishment of debt was \$3.1 million for the three months ended March 31, 2011. This non-recurring cost was a result of prepaying certain corporate indebtedness prior to maturity.

## **Property Acquisitions**

The Partnership closed the following property acquisitions during the three months ended March 31, 2011:

- In January 2011, Aviv Financing I acquired a property in Kansas from an unrelated third party for a purchase price of \$3,045,000. The Partnership financed this purchase through cash and borrowings of \$2,131,000.
- In March 2011, Aviv Financing II acquired a property in Pennsylvania from an unrelated third party for a purchase price of approximately \$2,200,000. The Partnership financed this purchase through cash.
- In March 2011, Aviv Financing II acquired a property in Ohio from an unrelated third party for a purchase price of approximately \$9,581,000. The Partnership financed this purchase through cash.
- In March 2011, Aviv Financing II acquired a property in Florida from an unrelated third party for a purchase price of approximately \$10,000,000. The Partnership financed this purchase through borrowings of \$10,200,000 under the Acquisition Revolver.

The Partnership closed the following property acquisitions subsequent to the three months ended March 31, 2011:

- On April 28, 2011 Aviv Financing II acquired three properties in Ohio from an unrelated third party for a purchase price of \$9,250,000. The Partnership financed this purchase with cash.
- On April 29, 2011 Aviv Financing II acquired six properties in Texas, Kansas, and Missouri from unrelated third parties for a purchase price of \$17,570,000. The Partnership financed this purchase with cash.
- On May 2, 2011, Aviv Financing II acquired three properties in Kansas from an unrelated third party for a purchase price of approximately \$2,273,000. The Partnership financed this purchase with cash.
- On May 3, 2011, Aviv Financing II acquired a property in Connecticut from an unrelated third party for a purchase price of \$12,000,000. The Partnership financed this purchase with cash.

## **Liquidity and Capital Resources**

We expect to meet our short-term liquidity requirements generally through net cash provided by operations, existing cash balances and, if necessary, short-term borrowings. We believe that the net cash

provided by operations and availability under our revolving credit facility will be adequate to fund our operating requirements, debt service and the payment of dividends in accordance with REIT requirements of the federal income tax laws for the next twelve months. We expect to meet our long-term liquidity requirements, such as scheduled debt maturities and property acquisitions, through long-term secured and unsecured borrowings and the issuance of additional equity securities.

Our organizational documents do not limit the amount of indebtedness that we may incur, and we currently do not have a target leverage ratio. We intend to repay indebtedness incurred under our credit facilities from time to time, to provide capacity for acquisitions or otherwise, out of cash flow and from the proceeds of issuances of additional equity interests and other securities.

We intend to invest in additional properties and portfolios as suitable opportunities arise and adequate sources of financing are available. We are currently evaluating additional potential investments consistent with the normal course of our business. These potential investments are in various stages of evaluation with both existing and new tenants and include acquisitions, development projects, income producing capital expenditures and other investment opportunities. Our ability to complete investments is subject to a number of risks and variables, including our ability to negotiate mutually agreeable terms with the counterparties and our ability to finance the purchase price. We may not be successful in identifying and consummating suitable acquisitions or investment opportunities, which may impede our growth and negatively affect our results of operations and may result in the use of a significant amount of management resources. We expect that future investments in properties will depend on and will be financed by, in whole or in part, our existing cash, the proceeds from issuances of securities or borrowings (including under our acquisition credit line and our revolving credit facility).

#### *Indebtedness Outstanding*

Our indebtedness outstanding is comprised principally of borrowings under our existing credit facility and our Senior Notes. We have a total indebtedness of approximately \$454.6 million as of March 31, 2011. Substantially all of such indebtedness is scheduled to mature in late 2015 or thereafter.

#### *Existing Credit Facility*

On September 17, 2010, our subsidiary Aviv Financing I, L.L.C. entered into a five year credit agreement with General Electric Capital Corporation, or GE, which provides a \$405.0 million mortgage term loan and a \$100.0 million acquisition credit line. The acquisition credit line is available for draw until September 2013. The initial term of the existing credit facility expires in September 2015 with two one-year extension options, provided that certain conditions precedent for the extensions are satisfied, including, without limitation, payment of a fee equal to 0.25% of the then existing principal balance of the existing credit facility and meeting certain debt service coverage and debt yield tests.

Our GE credit facility generally requires the consolidated borrowers under the facility to maintain a debt service coverage ratio of 1.50:1.00 and a distribution coverage ratio of 1.10:1.00. In addition, Aviv Healthcare Properties Limited Partnership and its consolidated subsidiaries must maintain a debt service coverage ratio of 1.25:1.00 and a debt yield ratio of greater than 17.25%. We are permitted to include cash on hand in calculating such debt service coverage ratios. Immediately following any draw on the acquisition credit line, both before and after giving effect to such draw, the consolidated borrowers under the existing credit facility must have a pro forma debt yield ratio of at least 18%.

Our debt yield ratio is the ratio of (i) either consolidated EBITDA or rental revenue for the most recently completed two fiscal quarter period times two to (ii) the average daily outstanding principal balance of loans outstanding under the existing credit facility during the period. The borrowers under the

existing credit facility guarantee the Notes, which guarantees are subordinated to the obligations of such borrowers under the existing credit facility. In turn, each guarantor of the Notes that is not a borrower under our existing credit facility or our revolving credit facility provided guarantees to the lenders under such facilities, which guarantees are subordinated to the obligations of such subsidiaries under the Notes.

As of March 31, 2011, we are in compliance with the financial covenants of our outstanding debt and lease agreements.

#### *7.75% Senior Notes due 2019.*

On February 4, 2011, we, through Aviv Healthcare Properties Limited Partnership and Aviv Healthcare Capital Corporation, (the “Issuers”), issued \$200.0 million aggregate principal amount of senior unsecured notes (the “Notes”) in a private placement. The Issuers are majority owned subsidiaries of Aviv REIT, Inc. (“Aviv REIT”). The Notes were sold at par, resulting in gross proceeds of \$200.0 million and net proceeds of approximately \$194.5 million after deducting commissions and expenses. The net proceeds from the offering of the Notes were used to repay all outstanding indebtedness under our acquisition credit line and to partially repay our outstanding mortgage term loan.

The obligations under the Notes are fully and unconditionally guaranteed, jointly and severally, on an unsecured basis, by Aviv REIT and certain of our other existing and, subject to certain exceptions, future subsidiaries.

The Notes are redeemable at the option of the Issuers, in whole or in part, at any time, and from time to time, on or after February 15, 2015, at the redemption prices set forth in the indenture governing the Notes (the “Indenture”), plus accrued and unpaid interest to the applicable redemption date. In addition, prior to February 15, 2015, the Issuers may redeem all or a portion of the Notes at a redemption price equal to 100% of the principal amount of the Senior Notes redeemed, plus a “make-whole” premium, plus accrued and unpaid interest to the applicable redemption date. At any time, or from time to time, on or prior to February 15, 2014, the Issuers may redeem up to 35% of the principal amount of the Notes, using the proceeds of specific kinds of equity offerings, at a redemption price of 107.75% of the principal amount to be redeemed, plus accrued and unpaid interest, if any, to the applicable redemption date.

The Indenture governing the Notes contains restrictive covenants that, among other things, restrict the ability of Aviv REIT, the Issuers and their restricted subsidiaries to: (i) incur or guarantee additional indebtedness; (ii) incur or guarantee secured indebtedness; (iii) pay dividends or distributions on, or redeem or repurchase, their capital stock; (iv) make certain investments or other restricted payments; (v) sell assets; (vi) create liens on their assets; (vii) enter into transactions with affiliates; (viii) merge or consolidate or sell all or substantially all of their assets; and (ix) create restrictions on the ability of Aviv REIT and its restricted subsidiaries to pay dividends or other amounts to Aviv REIT. The Indenture governing the Notes also provides for customary events of default, including, but not limited to, the failure to make payments of interest or premium, if any, on, or principal of, the Notes, the failure to comply with certain covenants and agreements specified in the Indenture for a period of time after notice has been provided, the acceleration of other indebtedness resulting from the failure to pay principal on such other indebtedness prior to its maturity, and certain events of insolvency. If any event of default occurs, the principal of, premium, if any, and accrued interest on all the then outstanding Notes may become due and payable immediately. As of March 31, 2011, we were in compliance with all applicable financial covenants under the Notes.

#### *Revolving Credit Facility*

In conjunction with the Senior Notes issuance on February 4, 2011, the Partnership, under Aviv Financing IV, LLC, entered into a \$25 million secured revolving credit facility with Bank of America (the “Revolver”). On each payment date, the Partnership shall pay interest only in arrears on any outstanding principal balance of the Revolver. The interest rate under our Revolver is generally based on LIBOR (subject to a floor of 1.0% and subject to our option to elect to use a prime base rate) plus a margin that is determined by our leverage ratio from time to time, and the interest rate as of March 31, 2011 was 6.25%. We are permitted to include cash on hand in calculating our leverage ratio for periods through June 30, 2011. The initial term of our Revolver expires in January 2014 with a one-year extension option. We have the right to increase the amount of the revolving credit facility by up to \$75.0 million (resulting in total availability of \$100.0 million), provided that certain conditions precedent are satisfied.

Our revolving credit facility is secured by first lien mortgages on 14 of our properties, a pledge of the capital stock of our subsidiaries owning such properties (plus the equity of our subsidiary that acts as the holding company of the subsidiaries owning such properties) and other customary collateral, including an assignment of leases and rents with respect to such mortgaged properties. The borrowing availability under our Revolver is subject to a borrowing base calculation based on, among other factors, the lesser of (i) the amount of a hypothetical mortgage based on the net revenues for the prior four quarters (on a pro forma basis for recently acquired properties) and (ii) 65% of the appraised value, in each case, of the properties securing our revolving credit facility. As of March 31, 2011, there was \$10.2 million outstanding on our Revolver.

The Revolver contains customary covenants that include restrictions on the ability to make acquisitions and other investments, pay dividends, incur additional indebtedness, and sell or otherwise transfer certain assets as well as customary events of default. The secured revolving credit facility also requires us to comply with specified financial covenants, which include a maximum leverage ratio, a minimum fixed charge coverage ratio and a minimum tangible net worth requirement. As of March 31, 2011, we were in compliance with all applicable financial covenants under the Revolver.

*Subsequent Event - \$100 million 7.75% Add-on Senior Notes*

On April 5, 2011, the Partnership issued \$100 million of 7.75% Senior Notes due February 2019 at a price of \$102.75 for an effective yield of 7.16%. The net proceeds from this issuance were used to pay down \$35.7 million of the mortgage term loan and the remaining proceeds were received as cash.

*Contractual Obligations*

The following table shows the amounts due in connection with the contractual obligations described below as of March 31, 2011 (including future interest payments).

	<b>Payments Due by Period</b>				
	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>More than 5 Years</b>	<b>Total</b>
	(in thousands)				
Mortgage term loan and other notes payable (1).....	\$ 12,682	\$ 35,121	\$218,830(2)	\$ —	\$ 266,633
7 ¾% Senior Notes due 2019 (3) .....	17,438	46,500	46,500	374,917	485,355
Total.....	<u>\$ 30,120</u>	<u>\$ 81,621</u>	<u>\$265,330(2)</u>	<u>\$ 374,917</u>	<u>\$ 751,988</u>

(1) Assumes \$201.0 million outstanding under our existing credit facility after giving effect to use of proceeds from the Existing Notes and the Notes offered hereby. See “Use of Proceeds.” Assumes a weighted average interest rate for total outstanding debt of 7.03%.

(2) Primarily relates to maturity of indebtedness under our existing credit facility in September 2015. Does not give effect to any amounts to be drawn under the acquisition credit line which would also mature in September 2015. See “—Borrowing Arrangements” below.

(3) Reflects \$200 million outstanding of our 7 ¾% Senior Notes due 2019.

### *Cash Flows*

#### *Three months Ended March 31, 2011 Compared to Three months Ended March 31, 2010*

- Cash provided by operations increased \$242,000, or 1.7%, from \$14.0 million for the three months ended March 31, 2010 to \$14.3 million for the same period in 2011. The increase was primarily due to an increase that resulted from additional rent associated with \$109 million of acquisitions and investments made in the twelve months ending March 31, 2011.
- Cash used in investing activities increased \$14.6 million, or 188.1%, from cash used of \$7.8 million for the three months ended March 31, 2010 to cash used of \$22.3 million for the same period in 2011. This increase was largely due to the increase in acquisition and investment activity in the twelve months ended March 31, 2011, as compared to the same period in 2010.
- Cash provided by financing activities increased \$19.8 million, or 145.1%, from cash used of \$13.6 million for the three months ended March 31, 2010 to cash provided of \$6.2 million for the same period in 2010. The increase was primarily due to a follow-on equity investment by Lindsay Goldberg in January 2011 and the issuance of our Senior Notes in February 2011.

### **Quantitative and Qualitative Disclosures About Market Risk**

Our future income, cash flows and fair values relevant to financial instruments are dependent upon prevalent market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. We use some derivative financial instruments to manage, or hedge, interest rate risks related to our borrowings. We do not use derivatives for trading or speculative purposes and only enter into contracts with major financial institutions based on their credit rating and other factors.

We entered into a swap arrangement on November 5, 2010 to hedge \$200 million of floating rate debt. If LIBOR were to increase by 100 basis points, we do not expect there would be any significant effect on the interest expense on our pro forma variable rate debt as our floating rate credit agreement is subject to a LIBOR floor of 125 basis points. Interest rate risk amounts were determined by considering the impact of hypothetical interest rates on our financial instruments. These analyses do not consider the effect of any change in overall economic activity that could occur in that environment. Further, in the event of a change of that magnitude, we may take actions to further mitigate our exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, these analyses assume no changes in our financial structure. The fair value of our debt outstanding as of March 31, 2011 was approximately \$455 million.