FINANCIALS 2003
SUNRISE SENIOR LIVING, INC.

SELECTED FINANCIAL DATA

The selected consolidated financial data set forth below should be read in conjunction with Sunrise's Consolidated Financial Statements and notes thereto included elsewhere herein.

(dollars in thousands, except per share amounts)	December 31, 2003[1]	2002	2001	2000	1999[2]
Statement of Operations Data:					
Operating revenue	**$1,188,301**	$ 505,912	$ 428,219	$ 344,786	$ 255,219
Management services expenses	**692,917**	156,251	82,734	22,157	13,623
Facility operating expenses	**254,203**	167,354	168,602	169,966	131,055
General and administrative expenses	**72,596**	36,944	32,809	27,418	20,715
Depreciation and amortization expenses	**16,406**	25,317	28,475	33,902	25,448
Interest expense, net	**16,571**	24,120	25,315	37,566	21,750
Net income[3]	**62,178**	54,661	49,101	24,278	20,213
Net income per common share:					
Basic	**2.92**	2.44	2.25	1.12	0.96
Diluted	**2.63**	2.23	2.08	1.10	0.94
Balance Sheet Data (at end of period):					
Cash and cash equivalents	**$ 102,548**	$ 173,119	$ 50,275	$ 42,874	$ 53,540
Working capital (deficit)	**71,123**	139,639	38,803	(34,063)	95,480
Total assets	**1,009,798**	1,116,151	1,177,615	1,129,361	1,101,413
Total debt	**222,990**	456,969	630,756	674,703	700,943
Stockholders' equity	**490,276**	465,818	410,701	354,045	335,124
Operating and Other Data:					
Ratio of earnings to fixed charges[4]	**2.97x**	2.50x	2.49x	1.57x	1.52x
Net cash provided by operating activities	**38,818**	98,817	101,485	62,477	42,787
Net cash (used in) provided by investing activities	**237,464**	211,935	(52,518)	(34,258)	(235,065)
Net cash (used in) provided by financing activities	**(346,853)**	(187,908)	(41,566)	(38,885)	191,621
Properties (at end of period):					
Owned	**186**	181	162	147	126
Managed	**187**	28	24	17	14
Total	**373**	209	186	164	140
Resident capacity:					
Owned	**19,100**	14,278	12,607	11,380	9,756
Managed	**23,651**	2,322	2,190	1,503	1,289
Total	**42,751**	16,600	14,797	12,883	11,045

(1) On March 28, 2003, Sunrise completed its acquisition of all of the outstanding stock of Marriott International, Inc.'s wholly owned subsidiary, Marriott Senior Living Services, Inc. (MSLS), which owns and operates senior independent full-service and assisted living properties. Sunrise paid approximately $92 million in cash to acquire all of the outstanding stock of MSLS. Sunrise also assumed approximately $29 million of working capital liabilities and other funding obligations as well as approximately $25 million of life care endowment obligations, the majority of which are expected to be refinanced with proceeds from the issuance of new endowment obligations as new residents enter the communities. The acquisition of MSLS was accounted for using the purchase method of accounting and the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values.

(2) On May 14, 1999, we completed our acquisition of Karrington through a tax-free, stock-for-stock transaction in which we issued 2.3 million shares of our common stock in exchange for all outstanding shares of Karrington and Karrington became a wholly owned subsidiary of Sunrise. The common stock issued in the transaction, together with related merger costs, had a value of $85 million. The transaction was accounted for using the purchase method of accounting and, accordingly, the results of operations of Karrington since the acquisition are included in our financial information for 1999.

(3) Net income for the year ended December 31, 2001 included a $2 million non-recurring item ($1 million after tax), which consisted of a $9 million cash payment, net of expenses, received by us in connection with a settlement of a lawsuit filed by Karrington prior to our acquisition of Karrington, and $7 million of non-recurring charges associated with writing down project costs as a result of our decision not to proceed with our planned development of five sites. Net income for the year ended December 31, 1999 included $5 million of non-recurring charges ($4 million after tax), of which $4 million related to the consolidation and integration of the acquired operations and development pipeline of Karrington and $1 million related to the termination of a property acquisition agreement. Of these non-recurring charges, $4 million were non-cash transactions.

(4) Computed by dividing earnings by total fixed charges. Earnings consist of earnings from continuing operations excluding unusual charges or extraordinary items, plus fixed charges, reduced by the amount of unamortized interest capitalized. Fixed charges consist of interest on debt, including amortization of debt issuance costs, and a portion of rent expense estimated by management to be the interest component of such rentals.

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

The following discussion should be read together with the information contained in our consolidated financial statements, including the related notes, and other financial information appearing elsewhere herein. This management's discussion and analysis contains certain forward-looking statements that involve risks and uncertainties. Although we believe the expectations reflected in such forward looking statements are based on reasonable assumptions, there can be no assurance that our expectations will be realized. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including, but not limited to, development and construction risks, acquisition risks, business conditions, competition, changes in interest rates, our ability to manage our expenses as a percentage of revenues under management, market factors that could affect the value of our properties, the risks of downturns in economic conditions generally, success in integrating Marriott Senior Living's operations and other acquisitions, satisfaction of closing conditions and availability of financing for development and acquisitions. These and other risks are detailed in the Company's annual report on Form 10-K, filed with the Securities and Exchange Commission. We assume no obligation to update or supplement forward-looking statements that become untrue because of subsequent events. Unless the context suggests otherwise, references herein to "we," "us" and "our" mean Sunrise Senior Living, Inc. and its consolidated subsidiaries.

Overview

We are a provider of senior living services in the United States, Canada and the United Kingdom. Founded in 1981, we began with a simple but innovative vision—to create an alternative senior living option that would emphasize quality of life and quality of care. As of December 31, 2003, we operated 361 communities in the United States, nine communities in Canada and three communities in the United Kingdom, with a total resident capacity of approximately 43,000. Of these, 186 are communities owned by us or in which we have an ownership interest and 187 are communities managed for third parties. Our communities offer a full range of personalized senior living services, from independent living, to assisted living, to care for individuals with Alzheimer's and other forms of memory loss, to nursing and rehabilitative care. In addition, we develop senior living communities for ourselves, for joint ventures in which we retain an ownership interest and for third parties.

In 2003, we completed our long-range strategic objective of transforming ourselves into a senior living management services company through (1) the closing and integration of two significant acquisitions of management contracts (see "Recent Developments" below), (2) the development of new communities primarily through joint ventures and (3) the continuation of our sale/long-term manage back program. We believe that this transformation has and will continue to result in more stable and predictable revenue and earnings streams as they become increasingly based on long-term management contracts.

Recent Developments

On March 28, 2003, we completed our acquisition of all the outstanding stock of Marriott International, Inc.'s wholly owned subsidiary, Marriott Senior Living Services ("MSLS"), which owns and operates senior independent full-service and assisted living communities. With the closing of this acquisition, we assumed management of an additional 129 operating communities with a total resident capacity of more than 23,000. These communities consisted of 108 management contracts and 21 operating leases. At closing, a majority of MSLS' approximately 15,000 employees remained employed by MSLS, which has been renamed Sunrise Senior Living Services.

The MSLS portfolio currently includes 126 communities located in 29 states with a resident capacity of approximately 22,800, net of the termination of three operating leases during the third quarter of 2003. The majority of the communities are clustered in major metropolitan markets, which is consistent with Sunrise's operating strategy. Approximately 50 percent of the resident capacity of the portfolio is assisted living, 34 percent is independent living and 16 percent is skilled nursing.

On June 30, 2003, we acquired the remaining majority interest in seven senior living communities in which we previously maintained a minority ownership interest. The majority interest holder was Catholic Health Initiatives, ET AL. ("CHI"), a not-for-profit entity. In order to acquire the remaining ownership interest, we assumed approximately $21 million in debt and paid approximately $2 million in cash. Since this acquisition occurred on June 30, 2003, our income statement reflects our minority ownership position in the communities for the first half of 2003 and complete results of operation for the communities for the second half of 2003.

On September 23, 2003, we closed on a commitment from a syndicate of banks for a $200 million corporate credit facility with expansion options. The facility has an initial term of three years with an extension option. Proceeds will be used for general corporate purposes, including investments, acquisitions and the refinance of existing debt. Consistent with our transformation to a management services company, the facility is not secured by real estate and replaces the $265 million syndicated revolving credit facility, which was primarily used for construction of wholly owned senior living properties.

In November 2003, we assumed management of 22 Edencare Senior Living Services communities, located in the southern United States. The 22 communities have a resident capacity of approximately 2,000. This new management contract transaction is in-line with our growth strategy to strengthen our presence in existing markets while introducing Sunrise Senior Living services to new locations. Also, this transaction advances our strategy to transition into a management services company, as we do not own the real estate of these communities.

In addition, we also completed the sale of 43 consolidated communities pursuant to our sale/long-term manage back program. We will continue to operate all 43 of these communities under long-term management agreements.

Critical Accounting Policies

Development of Communities

We develop senior living communities in partnership with others and typically develop several wholly owned senior living communities each year. We believe we have maintained a disciplined approach to site selection and refinement of our operating model, first introduced over 20 years ago, and are constantly searching for ways to improve our communities.

At December 31, 2003, we had four wholly owned communities under construction with a resident capacity of over 350 residents. With respect to these development communities, we are required to fund the construction of the community not otherwise financed by construction loans, capitalize the community development costs associated with construction, recognize initial operating losses from the community during the initial one to two years prior to the community achieving occupancy stabilization and recognize ongoing depreciation expense associated with owning the real estate. We are committed to this investment in costs and expenses because we have historically been able to create significant value through the successful development and operation of wholly owned prototype communities. In 2003, start-up losses for 100% owned communities that have not reached stabilized occupancy were $3 million and depreciation expense for our owned communities was $13 million.

We also enter into development joint ventures in order to reduce our initial capital requirements, while enabling us to enter into long-term management agreements that are intended to provide us with a stream of revenue. Additionally, these development joint ventures allow us to reduce the risk of our international expansion, which we conduct through joint ventures, with the assistance of knowledgeable international partners. When development is undertaken in partnership with others, our joint venture partners provide significant cash equity investments, and we take a minority interest in such ventures. Additionally, nonrecourse third-party construction debt is obtained to provide the majority of funds necessary to complete development. At December 31, 2003, these joint ventures have developed or are developing 60 communities (14 of which are under construction) with approximately $220 million of third-party debt and approximately $724 million of third-party equity.

As a part of our operating strategy, we may provide limited debt guarantees to certain of our development joint ventures. Unless otherwise stated, we would be required to perform under a debt guarantee if the business venture failed to perform under the debt agreement and the bank pursued our guarantee. As of December 31, 2003, we guaranty $33 million of debt for our development joint ventures. Of the $33 million, $19 million are last dollar debt guarantees on international development. Last dollar debt guarantee means the third-party debt would have to default, the bank would have to enforce any remedies against the venture, including foreclosure, after which we would have to provide any required funds to make up any difference between the loan amount and the amount recovered from such enforcement. Of the $33 million in debt guarantees to development joint ventures, $7 million are removed upon stabilization of the underlying communities, which is generally within 12 to 20 months. The remaining $26 million will remain in place throughout the term of the loan. We receive a fee in all situations where we have provided a debt guarantee. These fees are recognized over the period covered by the respective debt guarantee. To date, we have not been required to fund any debt guarantees due to the positive performance of the underlying communities. At December 31, 2003, we do not believe that we will be required to fund under our current outstanding debt guarantees. If we were required to fund a debt guarantee, we would loan the joint venture the required funds at the prevailing market interest rate. If circumstances were to suggest that any amounts with respect to these loans would be uncollectible, we would establish a reserve to write-down the loan to its collectible value.

For all of our development joint ventures, we earn pre-opening fees for site selection, zoning, construction supervision, employee selection, licensing, training and marketing efforts. These fees are included in the "Management services" line item on our consolidated income statement. As we are minority owners in these joint ventures, we only record the fee revenue associated with the third-party ownership percentage of the joint venture. For example, when our joint venture partner has a 75% ownership interest in the joint venture, we only record 75% of the fee revenue.

As part of our fee-development for joint ventures, we typically guarantee that communities will be completed at budgeted costs approved by all partners in the joint venture. Budgeted costs typically include significant contingency reserves for unforeseen costs and potential overruns. We would be required to fund these guarantees if the actual costs of development exceeded the approved budgeted costs. At December 31, 2003, 14 properties are under construction and subject to completion guarantees. We have over 20 years' experience in the development and construction of senior living communities. Our construction contractors are experienced in building our prototype and assume much of the risk of on-time and on-budget completion by executing fixed-price contracts. Typically, the terms of these guarantees provide for no limitation to the maximum potential future payments under the guarantee. In certain agreements, if amounts are required to be funded by us, they would become loans to the venture and earn interest. We closely monitor these projects and do not expect to fund any amounts under these development completion guarantees during 2004. If we were required to provide funds under a development completion guarantee, we could provide additional capital contributions to the joint venture to meet our obligation, if provided in the joint venture and guarantee agreement, or we would expense amounts provided under the development completion guarantee.

In addition to the third-party debt, we may provide financing necessary to complete the construction of the communities within these joint ventures. These loans are presented on our consolidated balance sheet in the "Notes receivable—affiliates" line item and were $71 million at December 31, 2003. This financing is provided at negotiated prevailing market interest rates. We monitor the collectibility of these notes based on the current performance of the open communities, the budgets and projections for future performance and the estimated fair value that has been created by the successful completion and operation of these communities. To date, we have not recorded any reserves against these notes based on our analysis of the preceding factors and, at December 31, 2003, expect that repayment of these notes will be made. If circumstances were to suggest that any amounts with respect to these notes would be uncollectible, we would establish a reserve to write-down the note to its collectible value.

In addition to the foregoing, we may provide limited debt guarantees to certain of our joint ventures. Unless otherwise stated, we would be required to perform under a debt guarantee if the business venture failed to perform under the debt agreement and the bank pursued our guarantee. At December 31, 2003, we have guaranteed $106 million of debt for our business ventures which represents our maximum exposure under our debt guarantees. Of the $106 million, $2 million of guarantees are for our sale/long-term manage back partnerships. These guarantees are removed upon reaching certain occupancy and debt service coverage targets within the partnership. Of the $106 million, $4 million represents a debt guarantee to a joint venture that was acquired in June 2002. This debt guarantee remains in place throughout the term of the loan. Sunrise has provided $9 million of debt guarantees to hospital partnerships that remain in place throughout the term of the loan. In addition, we have provided $91 million in debt guarantees and financing obligations associated with management contracts. In connection with the acquisition of MSLS in March 2003, CNL Retirement Properties, Inc. ("CNL") agreed to assume the obligation to repay $83 million of life care endowment obligations issued by MSLS with respect to two continuing care retirement communities. To the extent that CNL fails to satisfy this obligation, we would be required to repay this obligation, the majority of which is expected to be refinanced with proceeds from the issuance of new endowment obligations as new residents enter the communities. The remaining $8 million of the $91 million in debt guarantees and financing obligations associated with management contracts is made up of $2 million of obligations to provide financing under existing credit facilities with respect to four communities, $5 million of obligations to provide credit financing for 22 communities and $1 million of payment guarantees under operating agreements with respect to one community. As of December 31, 2003, we have not been required to fund any debt guarantees.

Management of Properties

We manage and operate communities wholly owned by us, owned by joint ventures in which we have a minority ownership interest and owned completely by third parties. For the communities that we manage for third parties, we typically are paid a management fee of approximately 5% to 8% of the property's revenue. In addition, in certain management contracts, we have the opportunity to earn incentive management fees based on monthly or yearly operating or cash flow results. Management fee revenue is included in the "Management services" line item on our consolidated income statement.

As a part of certain management contracts, we may provide an operating deficit credit facility. This means that if a community has depleted all of its operating reserves and does not generate enough cash flow during a month to cover its expenses, we would provide a loan to the property to cover the cash shortfall. These loans are generally included with our development joint ventures and usually are provided for a limited period of time, generally until the property reaches stabilization, which is within 12 to 20 months. Typically, the terms of these loans provide for no limitation to the maximum potential future payments under the loans. As of December 31, 2003, 19 operating communities are subject to a Sunrise operating deficit credit facility and 14 additional communities will be subject to a credit facility upon opening. Sunrise funded $0.4 million under these credit facilities in 2003 related to four communities and does not expect to fund any additional amounts under these credit facilities. The amounts funded in 2003 were recorded as loans to the ventures and are expected to be recoverable from cash flows from operations of the ventures.

Sale/Long-Term Manage Back Program

In 2000, we announced our intention to sell selected owned properties as a normal part of our operations and retain long-term management contracts and, in many cases, minority equity interests in the properties. We believe that this strategy of selling selected properties as part of our normal operations has and will continue to enable us to reduce our debt, re-deploy our capital into new development projects and realize cash gains on appreciated real estate. Under our sale/long-term manage back program, we sell wholly owned properties that we previously developed. This approach requires that we reflect in our income statement many expenses associated with these properties prior to their sale, including certain development expenses, start-up losses and depreciation.

We have performed under our sale/long-term manage back program by selling some properties 100% to third-parties and retaining a long-term management contract and selling some properties to joint ventures in which we have a minority ownership interest, generally ranging from 10% to 25%. If we sell 100% of a property to a third-party owner, we recognize as a gain from the sale the difference between the purchase price and the book value of the property, less the costs to sell. Generally accepted accounting principles require that we remove the book value of the property from the "Property and equipment" line item on our consolidated balance sheet and remove from liabilities any debt paid off or assumed by the new owner in the transaction.

If we sell a property to a joint venture in which we have a minority ownership interest, we will recognize as a gain from the sale the difference between the purchase price and the book value of the property, less the costs to sell, adjusted to reflect only the gain associated with the third-party ownership in the joint venture. Generally accepted accounting principles require that we not record a gain on the portion of the sale associated with our remaining ownership in the joint venture. Generally accepted accounting principles also require that we record, at historical cost basis, our remaining ownership of the property sold and debt assumed by the joint venture as an investment. This investment is included in the "Investment in unconsolidated senior living properties" line item on the balance sheet. Further, as is the case with the sale of a 100% interest in a property, generally accepted accounting principles require that we remove the book value of the property from the "Property and equipment" line on our consolidated balance sheet and remove from liabilities any debt assumed by the new owner in the transaction. We generally do not provide seller financing in these transactions.

The recognition of the gain from these sales, as calculated above, in our consolidated income statement, which is recorded in the "Income from property sales" line item, is determined by the terms of the purchase and sale agreement. Often, the purchasers in these transactions require that the properties perform at a certain operating level for up to one-year following the sale transaction. The operating contingencies placed in these agreements require us to defer a portion of the gains until such operating contingencies have been met. If the operating contingencies are not met for an identified period, we would be required to repay a portion of the cash proceeds related to the specific contingency and would not be able to recognize the portion of the gain associated with that contingency. There have been sale transactions in this sale/long-term manage back program that have not required such operating contingencies. In these instances, we would record the gain in the period in which the sale occurred. The balance of the unrecognized gains on properties sold in prior periods is included in the "Deferred revenue" line of our consolidated balance sheet.

In certain transactions, we have provided support arrangements for portfolios that have properties in lease-up. These arrangements are for limited periods of time and require payments if operating cash flow is below stated targets. Based on our expectations of operating performance over the life of the arrangement, we establish a reserve against the gain and proceeds from sales to fund potential payments. We currently have three joint venture agreements comprising 47 properties that are subject to lease-up support arrangements.

For financial statement purposes, we record a provision for income taxes on all gains we recognize on the sale of properties. For federal income tax purposes, many of our sales are treated as tax-free exchanges.

Off-Balance Sheet Arrangements

We utilize off-balance sheet arrangements in the form of real estate joint ventures. We believe that by owning a minority interest in the real estate underlying our long term management contracts, we retain the ability to influence the owners of our communities, reduce the risk to our shareholders of real estate ownership and receive potential upside from the sale of the joint venture. These joint ventures significantly reduce the amount of capital required of us to develop new communities. As part of our operating strategy, we may be required to provide some level of guarantees to these ventures, including limited debt guarantees and operating deficit guarantees. In addition, with respect to development joint ventures, we may provide financing necessary to complete the construction and we often provide development completion guarantees in the event actual costs of development exceed approved budgeted costs (see "Critical Accounting Policies" above).

For summary financial information for unconsolidated entities (7% to 50% owned) in which we have made investments, see Note 6 to our consolidated financial statements. For information regarding the notes receivable from our joint ventures, and guarantees and other commitments and contingencies to our joint ventures, see Notes 4 and 16 to our consolidated financial statements. Three of our joint ventures are variable interest entities under FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*. See Note 2 to our consolidated financial statements for a more detailed discussion of these three joint ventures.

As discussed in Note 18 to our consolidated financial statements, a director of Sunrise, Craig Callen, is a managing director of Credit Suisse First Boston (CSFB) LLC. The parent of CSFB LLC controls through funds sponsored by an affiliate or subsidiary, which from time to time have included investments in our joint ventures. We are providing management and pre-opening services to the joint ventures on a contract fee basis with rights to acquire the assets in the future.

We may allow minority equity ownership interests in joint ventures for our officers as a means of incentive. Currently, two of our corporate officers, Christian Slavin and Tiffany Tomasso, have minority ownership interests (less than 1% combined on a fully diluted basis) in one of our international joint ventures.

Results of Operations

We derive our consolidated revenues from three primary sources: (1) management services income for management services provided to communities owned by unconsolidated joint ventures and other third parties, (2) resident fees for the delivery of senior living services to our consolidated communities and (3) income from property sales. Historically, most of our operating revenues have come from management services and resident fees. In 2003, 2002 and 2001, management services and resident fees comprised 94%, 85% and 85% of total operating revenues, respectively. The balance of our total operating revenues was derived from income from property sales.

Management services income represents fees from long-term contracts for communities owned by unconsolidated joint ventures and other third party owners. Reimbursable expenses paid by us for the unconsolidated joint ventures are also reflected as revenues in the income statement, as required by contract accounting, and are offset by a corresponding amount reflected in the "Management services expense" line item. Management services income also includes management fees for operating communities, which are generally in the range of 5% to 8% of a managed community's total operating revenue for communities in operation, and pre-opening service fees for site selection, zoning, property design, construction management, hiring, training, licensing and marketing services.

Residents, their families, other responsible parties and Medicare/Medicaid typically pay resident fees monthly. In 2003, 2002 and 2001, approximately 93%, 99% and 99% of our resident fee revenue was derived from private pay sources. As a result of the MSLS acquisition, approximately six percent of our resident fee revenue in 2003 was derived from Medicare/Medicaid. Resident fees from residents in our assisted living communities include revenue derived from basic care, skilled nursing care, community fees, extended levels of care, *Reminiscence* care and other resident related services. Additional fees are paid by residents who require personal care in excess of services provided under the basic care program or services for cognitively impaired residents.

Income from property sales represents the gain recognized from the sale of senior living properties. Generally, upon sale of a property, we will enter into a long-term management agreement to manage the property.

We classify our operating expenses into the following categories: (1) management services, which includes development and pre-opening expense and operating expenses reimbursable to us with regards to communities owned by unconsolidated joint ventures and other third party owners; (2) facility operating, which includes labor, food, marketing and other direct facility expenses for our consolidated communities; (3) general and administrative, which primarily includes headquarters and regional staff expenses and other overhead costs; (4) depreciation and amortization; and (5) facility lease, which represents rental expenses for communities not owned by us.

The following summarized table sets forth the components of our net income (in thousands):

	Year Ended December 31,		
	2003	2002	2001
Total operating revenue	**$1,188,301**	$505,912	$428,219
Total operating expenses	**1,074,633**	394,164	322,779
Non-recurring items	—	—	2,307
Income from operations	**113,668**	111,748	107,747
Interest income	**8,869**	11,338	13,168
Interest expense	**(25,440)**	(35,458)	(38,483)
Equity in earnings (losses) of unconsolidated senior living properties	**1,161**	695	(1,169)
Minority interests	**(1,105)**	(160)	(769)
Income before income taxes	**97,153**	88,163	80,494
Provision for income taxes	**(34,975)**	(33,502)	(31,393)
Net income	**$ 62,178**	$ 54,661	$ 49,101

Prior to the completion of the MSLS transaction, Sunrise reported the results of its operations by its two operating divisions—Sunrise Management Services and Sunrise Properties. With the completion of the MSLS acquisition and the transformation into a management services organization, Sunrise now operates within one defined business segment with activities related to management, development, and acquisition of senior living services both domestically and internationally. See Note 21 of our consolidated financial statements.

Year Ended December 31, 2003 Compared to the Year Ended December 31, 2002

During 2003, we continued to capitalize on our brand and management services experience by adding additional third-party management and development contracts. In 2003, we began operating 35 additional communities which we lease or in which we have an ownership interest and managing 133 additional communities for independent third parties, partially offset by the termination of one management contract and three leases acquired through the MSLS acquisition.

Total operating revenue increased by $682 million to $1.2 billion for the year ended December 31, 2003 from $506 million for the year ended December 31, 2002 primarily due to the increase in our operating portfolio resulting from the MSLS acquisition in March 2003. Net income increased 14% to $62 million for the year ended December 31, 2003, or $2.63 per share (diluted), from $55 million for the year ended December 31, 2002, or $2.23 per share (diluted). The increase in net income between the years ended December 31, 2003 and December 31, 2002 was mainly due to increased income from operations due to the MSLS acquisition and reduced interest expense as a result of a $234 million reduction in debt.

Operating Revenue

Management services revenues increased by $588 million to $772 million for the year ended December 31, 2003 from $184 million for the year ended December 31, 2002. This increase was primarily due to the growth in the number of communities managed by Sunrise or in the pre-opening phase. The total number of communities managed increased 140% to 307 communities at December 31, 2003, up from 128 communities at December 31, 2002. Excluding the 108 managed communities acquired on March 28, 2003 from MSLS, our operating portfolio increased 55%. This growth resulted primarily from the addition of 79 new management contracts during 2003, partially offset by the termination of eight management contracts. In addition, there was a 20% increase in the number of communities in unconsolidated joint ventures (120 versus 100), many of which are accounted for under contract accounting, which requires the presentation of reimbursable expenses as revenues in the income statement. These revenues are offset by a corresponding amount reflected in the management services expense line item.

Resident fees represent revenues earned from residents in our consolidated communities. Resident fees increased $93 million, or 37%, to $341 million for the year ended December 31, 2003 from $248 million for the year ended December 31, 2002. This increase includes $155 million due to the acquisition of 18 MSLS communities with operating leases, net of the termination of three operating leases in 2003, and $7 million due to the acquisition of the majority interest in seven senior living communities. In addition, there was an increase of $9 million in resident fees from other consolidated communities driven by increases in occupancy and average daily rate. Offsetting these increases, in part, was a decrease of $78 million due to the sale of 33 senior living communities in 2003.

Average resident occupancy for the 119 stabilized communities that we operated in both 2003 and 2002 and in which we have an ownership interest was 90.44% compared to 89.71%, respectively. We believe occupancy is an important indicator of revenue growth. Due in part to the larger size of our developments and the general increase in competition, the lease-up period (period of time from opening to stabilization) is now typically 12 to 20 months. Although the lease-up period is longer, we have not changed our definition of what we consider a stabilized community. We define stabilized communities as those we have an ownership interest in and have operated for at least 12 months or those that have achieved occupancy percentages of 95% or above at the beginning of the measurement period.

The average daily rate paid by residents for the 119 stabilized communities that we operated in both 2003 and 2002 and in which we have an ownership interest was $127 in 2003 compared to $121 in 2002. The increase is primarily due to a general increase in the basic care rate.

Income from property sales fluctuates depending on the timing of property sale transactions and the satisfaction of certain required operating contingencies in the sales transactions. For the year ended December 31, 2003, we recognized $35 million of gains previously deferred on property sales completed during 2002 as a result of certain operating contingencies being met in 2003. In addition, we recognized $41 million of gains from the sale/long-term manage back transactions completed in 2003. See Note 14 to our consolidated financial statements for a discussion of our sale/long-term manage back transactions.

Operating Expenses

Management services expenses increased $537 million to $693 million for the year ended December 31, 2003 from $156 million for the year ended December 31, 2002. This increase is consistent with the increase in management services revenues and is dictated by the number of unconsolidated joint venture and other third party owned communities accounted for under contract accounting. Contract accounting requires us to reflect the operating expenses of those managed communities as expenses of Sunrise. An offsetting revenue reimbursement is reflected in the management services revenue line item.

Facility operating expenses for the year ended December 31, 2003 increased $87 million, or 52%, to $254 million from $167 million for the year ended December 31, 2002. This increase includes $116 million due to the acquisition of 18 MSLS communities with operating leases, net of the termination of three operating leases in 2003, and $6 million due to the acquisition of the majority interest in seven senior living communities. In addition, there was an increase of $11 million in facility operating expenses from other consolidated communities due to increased insurance expense, labor expense and employee benefit costs. Offsetting these increases, in part, was a decrease of $46 million due to the sale of 33 senior living communities in 2003.

General and administrative expenses increased to $73 million for the year ended December 31, 2003 compared to $37 million for the year ended December 31, 2002. The $36 million increase in general and administrative expenses is primarily due to the substantial growth in the number of communities operated in 2003 and the increased overhead due to the MSLS acquisition. Included in general and administrative expenses for 2003 is $11 million in transition expenses related to the acquisition of MSLS. There will be no transition expenses incurred in 2004.

Depreciation and amortization expense for the year ended December 31, 2003 decreased 35% to $16 million from $25 million for the year ended December 31, 2002. This decrease correlates with the corresponding 35% decrease in property and equipment and properties held for sale.

Facility lease expenses for the year ended December 31, 2003 increased $30 million to $39 million from $8 million for the year ended December 31, 2002. This increase was due to the acquisition of 18 MSLS communities with operating leases, net of the termination of three operating leases in 2003.

Interest

Net interest expense for the year ended December 31, 2003 decreased to $17 million from $24 million for the year ended December 31, 2002. In accordance with FASB 145 (see Note 2 to our consolidated financial statements) the extraordinary loss recognized in 2002 of approximately $4 million ($2 million net of tax) for fees associated with the $92 million term loan and the premium paid for the early redemption of our 5½% convertible notes was reclassified to interest expense. Excluding this reclassification, the $3 million decline was due to a decrease of $6 million in interest expense partially offset by a $3 million decline in interest income. The decrease in interest expense was due to the decline in the interest rate that we pay on our variable rate debt. The weighted-average interest rate on our fixed and variable rate debt at December 31, 2003 was 4.50% compared to 6.02% at December 31, 2002. In addition, debt decreased from $457 million to $223 million, or 51%. The decrease in interest income was due to the decline in interest rates that we receive on short-term investments, a reduction in short term investments due to the acquisition of MSLS and the pay-down of notes receivable.

Provision for Income Taxes

The provision for income taxes was $35 million for the year ended December 31, 2003 compared to $34 million for the year ended December 31, 2002. The increase was primarily due to an increase in pre-tax income which was slightly offset by the use of an effective tax rate of 36% for the year ended December 31, 2003 compared to 38% for the year ended December 31, 2002. The decrease in the effective tax rate is due to a decrease in our state and international effective tax rates based upon our operating history and previous tax positions in those jurisdictions. We expect that our effective tax rate will increase in 2004.

Realization of the deferred tax asset of $24 million at December 31, 2003 is dependent on generating sufficient taxable income prior to the expiration of the loss carryforwards. We expect to fully utilize the loss carryforwards prior to expiration.

Year Ended December 31, 2002 Compared to the Year Ended December 31, 2001

We continued to experience growth in operations in the year ended December 31, 2002 and continued to capitalize on our brand awareness by adding additional third-party management and development contracts. During 2002, we began operating 21 additional communities in which we have an ownership interest and managing 7 additional communities for independent third parties, partially offset by four third party management contract terminations and the 100% sale of a wholly owned property in Iowa.

Total operating revenue increased 18% to $506 million for the year ended December 31, 2002 from $428 million for the year ended December 31, 2001. Net income increased 11% to $55 million for the year ended December 31, 2002, or $2.23 per share (diluted), from $49 million for the year ended December 31, 2001, or $2.08 per share (diluted). The increase in net income between the years ended December 31, 2002 and December 31, 2001 was mainly due to our sale/long-term manage back program which resulted in higher income, reduced interest expense as a result of a $174 million reduction in debt and lower depreciation and amortization expense.

Operating Revenue

Management services revenues include management services revenues from unconsolidated joint ventures and third-party owners. Management services revenues increased 74% to $184 million for the year ended December 31, 2002 from $106 million for the year ended December 31, 2001. This increase was primarily due to the growth in the number of communities managed by Sunrise or in the pre-opening phase. The total number of communities managed increased 49% to 128 communities at December 31, 2002, up from 86 communities at December 31, 2001. This growth resulted primarily from the addition of 46 new management contracts during 2003, partially offset by the termination of four management contracts. Additionally, there was a 61% increase in the number of communities in unconsolidated joint ventures (100 versus 62), the majority of which are accounted for under contract accounting, which requires the presentation of reimbursable expenses as revenues in the income statement. These revenues are offset by a corresponding amount reflected in the management services expense line item.

Resident fees represent revenues earned from residents in our consolidated communities. Resident fees decreased $13 million, or 5%, to $248 million for the year ended December 31, 2002 from $261 million for the year ended December 31, 2001. This decrease was due primarily to the sale of 12 properties in 2001 resulting in an $18 million decrease in 2002 resident fee revenue and the sale of 17 properties in the first nine months of 2002 resulting in a $32 million decrease in resident fee revenue in 2002. These decreases were partially offset by a $37 million increase from the remaining consolidated communities due to increases in occupancy and rate.

Average resident occupancy for the 119 stabilized communities that we operated in both 2002 and 2001 and in which we have an ownership interest was 91.07% compared to 90.82%, respectively. We attribute the increase in stabilized occupancy to improved performance of our current stabilized portfolio. Due in part to the larger size of our developments and the general increase in competition, the lease-up period (period of time from opening to stabilization) is now typically 12 to 15 months. Although the lease-up period is longer, we have not changed our definition of what we consider a stabilized community. We define stabilized communities as those we have an ownership interest in and have operated for at least 12 months or those that have achieved occupancy percentages of 95% or above at the beginning of the measurement period.

The average daily rate paid by residents for the 119 stabilized communities that we operated in both 2002 and 2001 and in which we have an ownership interest was $117 in 2002 compared to $109 in 2001. The increase is primarily due to a general increase in the basic care rate.

Income from property sales fluctuates depending on the timing of property sale transactions and the satisfaction of certain required operating contingencies in the sales transactions. For the year ended December 31, 2002, we recognized $6 million of gains previously deferred on property sales completed during 2001 as a result of certain operating contingencies being met in 2002. In addition, we recognized $68 million of gains from the sale/long-term manage back transactions completed in 2002. See Note 14 to our consolidated financial statements for a discussion of our sale/long term manage back transactions.

Operating Expenses
Management services expenses for the year ended December 31, 2002 increased $73 million to $156 million from $83 million for the year ended December 31, 2001. This increase is consistent with the increase in management services revenues and is dictated by the number of unconsolidated joint venture and other third party owned communities accounted for under contract accounting. Contract accounting requires us to reflect the operating expenses of those managed communities as expenses of Sunrise. An offsetting revenue reimbursement is reflected in the management services revenue line item.

Facility operating expenses for the year ended December 31, 2002 decreased $2 million to $167 million from $169 million for the year ended December 31, 2001. This decrease was due primarily to the sale of 12 properties in 2001 resulting in a $11 million decrease in facility operating expenses in 2002 and the sale of 17 properties in the first nine months 2002 resulting in a $17 million decrease in facility operating expenses in 2002. These decreases were substantially offset by a $26 million increase from the remaining consolidated properties due to increases in labor, insurance and utility costs.

General and administrative expenses increased by $4 million, or 13%, to $37 million for the year ended December 31, 2002 compared to $33 million for the year ended December 31, 2001. The general and administrative expenses continue to increase due to the substantial growth in the number of communities operated during this period.

Depreciation and amortization for the year ended December 31, 2002 decreased 11%, to $25 million from $28 million for the year ended December 31, 2001. This decrease was primarily due to the cessation of amortization of goodwill in accordance with new accounting guidance (see Note 2 to our consolidated financial statements) and the timing of property sales.

Facility lease expenses for the year ended December 31, 2002 decreased $2 million to $8 million from $10 million for the year ended December 31, 2001. This decrease was primarily due to the termination of four operating leases in January 2002. We terminated these leases and acquired the four properties on the balance sheet.

Interest
Net interest expense decreased $1 million, or 5% to $24 million for the year ended December 31, 2002 from $25 million for the year ended December 31, 2001. In accordance with FASB 145 (see Note 2 to our consolidated financial statements), the extraordinary loss recognized in 2002 of approximately $4 million ($2 million net of tax) for fees associated with the $92 million term loan and the premium paid for the early redemption of our 5½% convertible notes was reclassified to interest income. Also, the extraordinary gain recognized in 2001 of approximately $0.5, net of tax, in connection with the early extinguishment of $42 million of the outstanding 5½% convertible notes was reclassified to interest income. Excluding these reclassifications, the $6 million decline was due to a decrease of $7 million in interest expense partially offset by a $1 million decline in interest income. The decrease in interest expense was due to the decline in the interest rate that we pay on both our fixed and variable rate debt. Debt decreased from $631 million to $457 million, or 28%. The weighted-average interest rate on our variable rate debt at December 31, 2002 was 3.87% compared to 4.36% at December 31, 2001. The decrease in interest income was due to the decline in interest rates that we receive on short-term investments.

Non-recurring Items
During 2001, Karrington Health Inc., one of our wholly owned subsidiaries, received a cash payment in the amount of $10 million to settle a lawsuit filed by Karrington prior to its acquisition by us. Karrington brought the suit alleging that Omega Healthcare Investors, Inc. had breached a financing commitment it had made to Karrington. Expenses incurred to settle the lawsuit have been netted against the settlement.

In 2001, given the industry environment and the increasing number of opportunities to acquire properties and management contracts, we determined that the costs to develop five specific sites outweighed the costs of acquiring properties and/or management contracts in those areas. Accordingly, we elected not to proceed with our planned development for these five sites and wrote down associated project costs by $7 million to their estimated net realizable value.

Provision for Income Taxes
The provision for income taxes for us was $34 million and $31 million for the years ended December 31, 2002 and 2001, respectively. The increase was due primarily to an increase in pre-tax income which was slightly offset by the use of an effective tax rate of 38% for 2002 compared to 39% for 2001. The decrease in the effective tax rate is due to a decrease in our state effective tax rate.

Liquidity and Capital Resources
At December 31, 2003, we had approximately $103 million in unrestricted cash and cash equivalents, $225 million available under credit facilities and $71 million in working capital.

Working capital decreased by $69 million to $71 million at December 31, 2003 from $140 million at December 31, 2002 primarily due to the use of $92 million in cash to acquire MSLS and the associated current assets and liabilities in March 2003. See Note 13 to our consolidated financial statements for a discussion of the MSLS acquisition. Additionally, we repurchased approximately $106 million of our common stock and $5 million of our convertible debt during 2003.

Net cash provided by operating activities for 2003 and 2002 was approximately $39 million and $99 million, respectively. The decline in net cash provided by operating activities was primarily driven by the non-cash recognition of property sales in 2003 of $35 million and an increase in accounts receivable, prepaid assets and other assets due to the acquisition of MSLS.

Net cash provided by investing activities was $237 million and $212 million for 2003 and 2002, respectively. In 2003, we used $92 million for the acquisition of MSLS and $2 million for the acquisition of the majority ownership in seven senior living properties. Cash proceeds for the year ended December 31, 2003 consisted of $132 million from the sale of 33 senior living properties compared to $128 million from the sale of 28 senior living properties for the year ended December 31, 2002. Sales proceeds from property and equipment exceeded investments in property and equipment in the amount of $128 million and $99 million for the years ended December 31, 2003 and 2002, respectively.

Net cash used in financing activities was $347 million and $188 million for 2003 and 2002, respectively. Financing activities in 2003 and 2002 included additional borrowings of $270 million and $393 million, respectively, offset by debt repayments of $559 million and $569 million, respectively. The additional borrowings under our credit facility during 2003 and 2002 were used to fund our continued development of senior living communities. The increased levels of repayments are partially a result of our sale/long-term manage back program. Additionally, in 2003 we repurchased approximately $106 million of our common stock and $5 million of our convertible notes in 2003, compared to the repurchase of approximately $15 million of our common stock in 2002.

To date, we have financed our operations primarily with cash generated from operations, both short-term and long-term borrowings and proceeds from the sale of properties pursuant to our sale/long-term manage back program. As of December 31, 2003, we had $223 million of outstanding debt at a weighted average interest rate of 4.50% including $120 million of convertible notes. Of the amount of outstanding debt, we had $181 million of fixed-rate debt at a weighted average interest rate of 4.79% and $42 million of variable rate debt at a weighted average interest rate of 3.27%.

As of December 31, 2003, we had $22 million of debt that is due within the next twelve months. Of this amount, $20 million relates to six wholly owned properties. This debt is mortgage financing that we intend to refinance or extend during 2004.

On September 23, 2003, we closed on a commitment from a syndicate of banks for a $200 million corporate credit facility. The facility has an initial term of three years with an extension option. Proceeds will be used for general corporate purposes, including investments, acquisitions and the refinance of existing debt. Consistent with our transformation to a management services company, the facility is not secured by real estate and replaces the $265 million syndicated revolving credit facility, which was primarily used for construction of wholly owned senior living properties.

Our debt instruments contain various financial covenants and other restrictions, including provisions which require us to meet specified financial tests. For example, our $200 million line of credit requires us not to exceed certain leverage ratios, to maintain certain interest coverage ratios and to have a consolidated net worth of at least $387 million as adjusted each quarter and to meet other financial ratios. These tests are administered on a quarterly basis.

In January 2002, we issued and sold $125 million aggregate principal amount of 5¼% convertible subordinated notes due February 2009. The convertible notes bear interest at 5¼% per annum payable semiannually on February 1 and August 1 each year beginning on August 1, 2002. These notes are convertible into shares of our common stock at the conversion price of $35.84, which is equivalent to a conversion rate of 27.9018 shares per $1,000 principal amount of the convertible notes. The notes, which are subordinated to our existing and future senior indebtedness, are redeemable at our option commencing February 5, 2006. In addition, the holders of the convertible notes may require us to repurchase the notes upon a change of control as defined in the convertible notes. During 2003, we repurchased $5 million face amount of the convertible notes.

In 2001, we entered into five interest rate swap agreements whereby $125 million of advances outstanding on our variable LIBOR based revolving construction credit facility bear interest at a fixed rate. The maturity dates of the swap agreements ranged from June 2003 to June 2004. In December 2002, we paid $400,000 to terminate one of our five interest rate swap agreements. In 2003, we paid $3 million to terminate our remaining four interest rate swap agreements. As of December 31, 2003, we had a zero balance in accumulated other comprehensive income related to the terminated swap agreements. For the year ended December 31, 2003, we recognized $2 million in interest expense related to the amortization of the swap balance in accumulated other comprehensive income. Also, we wrote off $2 million of the swap balance in accumulated other comprehensive income as debt associated with the swap was repaid or assumed as part of the property sale transactions closed in the second and third quarters of 2003.

Our current contractual obligations include long-term debt and operating leases for our corporate and regional offices in addition to our 29 operating leases. See Note 7 and Note 16 of our consolidated financial statements for a discussion of our contractual obligations.

Principal maturities of long-term debt and future minimum lease payments as of December 31, 2003 are as follows (in thousands):

		Payment Due by Period			
Contractual Obligations	Total	Less than 1 Year	1–3 Years	3–5 Years	More than 5 Years
Long-term debt	$222,990	$22,162	$ 50,450	$ 13,609	$136,769
Operating leases	606,894	53,698	105,980	106,314	340,902
Total	$829,884	$75,860	$156,430	$119,923	$477,671

We currently estimate that the existing credit facilities, together with existing working capital, cash flows from operations, financing commitments and financing expected to be available, will be sufficient to fund our short term liquidity needs, including communities currently under construction. Additional financing will, however, be required to complete additional development and to refinance existing indebtedness. We estimate that it will cost approximately $50 million to complete the communities we currently have under construction. We have entered into contracts to purchase and lease additional sites. The total contracted purchase price of these sites is $49 million. We expect to develop the majority of these sites within joint ventures. This business model limits the amount of capital required of us to complete the development of the communities. We expect that the cash flow from operations, together with borrowings under existing credit facilities will be sufficient to fund our investment in the development and construction of these additional communities for at least the next twelve months. We expect from time to time to seek additional funding through public or private financing sources, including equity or debt financing. We can provide no assurance that such financing and refinancing will be available on acceptable terms.

Stock Repurchase Program

On July 23, 2002, we announced that our Board of Directors authorized us to repurchase outstanding shares of our common stock up to an aggregate purchase price of $50 million over the next 12 months. In 2002, we purchased 581,400 shares at an average price of $25.62 per share through open-market purchases. On May 7, 2003, our Board of Directors expanded our repurchase program to an aggregate of $150 million to repurchase outstanding shares of common stock of Sunrise and/or our outstanding 5¼% convertible subordinated notes due 2009. In 2003, we purchased another 3,959,400 shares at an average price of $26.83 bringing the total shares purchased through December 31, 2003 to 4,540,800 shares at an average price of $26.68. Additionally in 2003, we repurchased $5 million of our convertible debt. On March 11, 2004, our Board of Directors approved an additional $50 million for the repurchase of outstanding shares of common stock of Sunrise and/or our outstanding 5¼% convertible subordinated notes due 2009.

Market Risk

We are exposed to market risks related to fluctuations in interest rates on our notes receivable, investments and debt. The purpose of the following analyses is to provide a framework to understand our sensitivity to hypothetical changes in interest rates as of December 31, 2003.

We have investments in notes receivable and bonds. Investments in notes receivable are primarily with joint venture arrangements in which we have a minority equity ownership interest ranging from 7% to 50%. At December 31, 2003, we had minority equity ownership interests in 134 senior living properties, 14 of which are under development. We have 13 properties in which we own less than 10%, 89 properties in which we own between 10% and 20%, 28 properties in which we own between 21% and 30% and four properties in which we own more than 30%. Investments in bonds are secured by the operating properties subject to the debt and are with properties that are managed by us. The majority of the investments have fixed rates. Five of the notes have an adjustable rate.

We utilize a combination of debt and equity financing to fund our development, construction and acquisition activities. We seek the financing at the most favorable terms available at the time. When seeking debt financing, we use a combination of variable and fixed rate debt.

For fixed rate debt, changes in interest rates generally affect the fair market value of the debt, but not earnings or cash flows. Conversely, for variable rate debt, changes in interest rates generally do not impact fair market value of the debt, but do affect the future earnings and cash flows. We generally cannot prepay fixed rate debt prior to maturity without penalty. Therefore, interest rate risk and changes in fair market value should not have a significant impact on the fixed rate debt until we would be required to refinance such debt. Holding the variable rate debt balance of $42 million at December 31, 2003 constant, each one-percentage point increase in interest rates would result in an increase in interest expense for the coming year of approximately $0.4 million.

The table below details by category the principal amount, the average interest rates and the estimated fair market value. Some of the notes receivable and some items in the various categories of debt, excluding the convertible notes, require periodic principal payments prior to the final maturity date. The fair value estimates for the notes receivable are based on the estimates of management and on rates currently prevailing for comparable loans. The fair market value estimates for debt securities are based on discounting future cash flows utilizing current rates offered to Sunrise for debt of the same type and remaining maturity. The fair market value estimate of the convertible notes is based on the market value at December 31, 2003.

	Maturity Date						Estimated Fair Market Value
(dollars in thousands)	2004	2005	2006	2007	2008	Thereafter	
Assets							
Notes receivable							
Fixed rate	$26,290	—	$ 137	$3,571	—	$ 32,906	$ 62,904
Average interest rate	11.8%	—	10%	11.1%	—	10.5%	—
Variable rate	$ 2,686	—	—	—	$7,172	$ 4,591	$ 14,449
Average interest rate	6.0%	—	—	—	4.1%	4.6%	—
Investments							
Bonds	—	—	—	—	—	$ 5,610	$ 5,610
Average interest rate	—	—	—	—	—	11.0%	—
Liabilities							
Debt							
Fixed rate	$21,642	$ 3,115	$10,310	$9,785	$3,424	$ 12,969	$ 61,737
Average interest rate	5.6%	1.3%	4.5%	4.2%	1.0%	1.7%	—
Variable rate	$ 520	$17,337	$19,688	$ 200	$ 200	$ 3,800	$ 41,745
Average interest rate	3.1%	4.3%	2.5%	2.5%	2.5%	2.5%	—
Convertible notes	—	—	—	—	—	$120,000	$148,350
Average interest rate	—	—	—	—	—	5.3%	—

Impact of Changes in Accounting Standards

On January 1, 2002, we adopted Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*. In accordance with the new rule, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually for impairment. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives. Diluted net income and diluted earnings per share would have been $55 million and $2.11 per share, if SFAS No. 142 had been applied to 2001.

On January 1, 2003, we adopted Statement of Financial Accounting Standards (SFAS) No. 145, *Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS 145 requires companies to no longer report gains and losses associated with the extinguishment of debt as a component of extraordinary gains and losses, net of tax. These gains and losses are required to be presented within the statement of income in appropriate segregated line items. As required by SFAS 145, the extraordinary loss recognized in the year ended December 31, 2002 of approximately $4 million ($2 million net of tax) for fees associated with the $92 million term loan and premium paid for the early redemption of the convertible notes has been reclassified to interest expense.

On January 1, 2003, Sunrise adopted Statement of Financial Accounting Standards Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"). FIN 45 requires companies to initially record at fair value guarantees meeting the characteristics described in this interpretation, which is different from the general practice of recording a liability only when a loss is probable and reasonably estimable, as defined by FASB Statement No. 5, *Accounting for Contingencies*. The Interpretation also requires a guarantor to provide new disclosures for guarantees even if the likelihood of the guarantor's having to make payments under the guarantee is remote. The Interpretation's disclosure requirements are included in Note 16. The Interpretation's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The adoption of FIN 45 did not have a material impact on the consolidated financial position or results of operation of Sunrise.

On February 1, 2003, we adopted FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). Under this new Interpretation, companies are required to determine if they are the primary beneficiary of a variable interest entity. If they are the primary beneficiary, the variable interest entity must be consolidated. All companies with variable interests in variable interest entities created after January 31, 2003 must apply the provisions of the Interpretation immediately. Public companies with calendar year-end quarters with a variable interest in a variable interest entity created before February 1, 2003 must apply the provisions of this Interpretation as of March 31, 2004 in accordance with FIN 46 Revised.

Based on our review of FIN 46, we have determined that there are three joint ventures in which Sunrise has an interest that are variable interest entities under FIN 46. Two of the variable interest entities are development joint ventures, which were established in 1999 and 2003 and contain seven operating senior living communities. The other variable interest entity is an operating joint venture formed in 2000. We are not considered the primary beneficiary of these three variable interest entities and therefore will continue to account for these investments under the equity method of accounting. Our remaining joint venture interests are not variable interest entities under FIN 46 as, among other factors, there is adequate equity in the joint ventures to support expected operations, there is sufficient third party capital and no guarantees of returns or capital, and we would not be deemed the primary beneficiary in these ventures. We are in the process of determining the effect of FIN 46, as passed in December 2003, on these three variable interest entities. Sunrise's maximum exposure from these entities was $28 million at December 31, 2003.

Our joint ventures fall into one of three categories. First, we enter into development joint ventures whereby a third-party investor and we capitalize a joint venture to develop and operate senior living communities. Second, we and a third-party investor capitalize a joint venture to acquire an existing senior living property. Finally, as a part of our sale long-term manage back program, we sell owned properties into a joint venture in which we hold a minority interest that is then capitalized by a third-party investor. These partnerships obtain non-recourse third-party debt. We do not have future requirements to contribute additional capital over and above the original capital commitments. All three types of joint ventures are established as real estate partnerships to own the underlying property. We will then enter into a long-term management contract to operate the property on behalf of the joint venture. Our total investment in these joint ventures is comprised of our direct capital investment in these joint ventures and, when agreed to, subordinated debt provided and other short-term advances. As of December 31, 2003, this total investment was $157 million, not including any guarantees provided to these joint ventures as described in Note 16. The realization of this investment is dependent upon the ongoing operations of the joint ventures. See Note 6 for operating results of the joint ventures.

Impact of Inflation

Management services income from communities operated by us for third parties and resident fees from owned senior living communities are the primary sources of revenue. These revenues are affected by daily resident fee rates and property occupancy rates. The rates charged for the delivery of senior living services are highly dependent upon local market conditions and the competitive environment in which the communities operate. In addition, employee compensation expense is the principal cost element of community operations. Employee compensation, including salary and benefit increases and the hiring of additional staff to support our growth initiatives, have previously had a negative impact on operating margins and may again do so in the foreseeable future.

Substantially all of our resident agreements are for terms of one year, but are terminable by the resident at any time upon 30 days' notice, and allow, at the time of renewal, for adjustments in the daily fees payable, and thus may enable us to seek increases in daily fees due to inflation or other factors. Any increase would be subject to market and competitive conditions and could result in a decrease in occupancy of our communities. We believe, however, that the short-term nature of our resident agreements generally serves to reduce the risk to us of the adverse effect of inflation. There can be no assurance that resident fees will increase or that costs will not increase due to inflation or other causes.

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)	December 31, 2003	2002
Assets		
Current Assets:		
Cash and cash equivalents	**$ 102,548**	$ 173,119
Accounts receivable, net	**46,329**	21,648
Notes receivable—affiliates	**28,976**	10,180
Deferred income taxes	**23,570**	15,873
Prepaid expenses and other current assets	**34,472**	33,566
Total current assets	**235,895**	254,386
Property and equipment, net	**412,228**	299,683
Properties held for sale	**—**	337,233
Notes receivable—affiliates	**48,377**	77,112
Management contracts and leaseholds, net	**82,395**	12,140
Costs in excess of assets acquired, net	**106,139**	32,749
Investments in unconsolidated senior living properties	**73,834**	64,375
Investments	**5,610**	5,610
Other assets	**45,320**	32,863
Total assets	**$1,009,798**	$1,116,151
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable and accrued expenses	**$ 111,381**	$ 48,016
Deferred revenue	**31,229**	37,316
Current maturities of long-term debt	**22,162**	29,415
Total current liabilities	**164,772**	114,747
Long-term debt, less current maturities	**200,828**	427,554
Investments in unconsolidated senior living properties	**3,371**	2,901
Deferred income taxes	**129,661**	96,112
Other long-term liabilities	**19,287**	7,158
Total liabilities	**517,919**	648,472
Minority interests	**1,603**	1,861
Preferred stock, $0.01 par value, 10,000,000 shares authorized, no shares issued and outstanding	**—**	—
Common stock, $0.01 par value, 60,000,000 shares authorized, 20,987,730 and 22,343,815 shares issued and outstanding in 2003 and 2002, respectively	**210**	223
Additional paid-in capital	**273,378**	312,952
Retained earnings	**221,109**	158,931
Deferred compensation—restricted stock	**(6,564)**	(3,333)
Accumulated other comprehensive income (loss)	**2,143**	(2,955)
Total stockholders' equity	**490,276**	465,818
Total liabilities and stockholders' equity	**$1,009,798**	$1,116,151

See accompanying notes.

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)	Year Ended December 31, **2003**	2002	2001
Operating revenue:			
Management services	**$ 771,947**	$183,603	$105,541
Resident fees	**340,775**	248,098	260,524
Income from property sales	**75,579**	74,211	62,154
Total operating revenue	**1,188,301**	505,912	428,219
Operating expenses:			
Management services	**692,917**	156,251	82,734
Facility operating	**254,203**	167,354	168,602
General and administrative	**72,596**	36,944	32,809
Depreciation and amortization	**16,406**	25,317	28,475
Facility lease	**38,511**	8,298	10,159
Total operating expenses	**1,074,633**	394,164	322,779
Non-recurring items	**—**	—	2,307
Income from operations	**113,668**	111,748	107,747
Interest income (expense):			
Interest income	**8,869**	11,338	13,168
Interest expense	**(25,440)**	(35,458)	(38,483)
Net interest expense	**(16,571)**	(24,120)	(25,315)
Equity in earnings (losses) of unconsolidated senior living properties	**1,161**	695	(1,169)
Minority interests	**(1,105)**	(160)	(769)
Income before income taxes	**97,153**	88,163	80,494
Provision for income taxes	**(34,975)**	(33,502)	(31,393)
Net income	**$ 62,178**	$ 54,661	$ 49,101
Net income per common share:			
Basic:			
Basic net income per common share	**$ 2.92**	$ 2.44	$ 2.25
Diluted:			
Diluted net income per common share	**$ 2.63**	$ 2.23	$ 2.08

See accompanying notes.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(in thousands)	Shares of Common Stock	Common Stock Amount	Additional Paid-in Capital	Deferred Compensation	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2000	21,596	$216	$ 298,660	$ —	$ 55,169	$ —	$ 354,045
Net income					49,101		49,101
Interest rate swaps, net of tax						(3,121)	(3,121)
Foreign currency translation, net of tax						(1,093)	(1,093)
Total comprehensive income							44,887
Issuance of common stock to employees	570	6	9,110				9,116
Tax effect from the exercise of non-qualified stock options			2,653				2,653
Balance at December 31, 2001	22,166	222	310,423	—	104,270	(4,214)	410,701
Net income					54,661		54,661
Interest rate swaps, net of tax						610	610
Foreign currency translation, net of tax						649	649
Total comprehensive income							55,920
Issuance of common stock to employees	611	6	11,028				11,034
Repurchase of common stock	(581)	(6)	(14,892)				(14,898)
Issuance of restricted stock	148	1	4,020	(4,021)			—
Amortization of restricted stock				688			688
Tax effect from the exercise of non-qualified stock options			2,373				2,373
Balance at December 31, 2002	22,344	223	312,952	(3,333)	158,931	(2,955)	465,818
Net income					62,178		62,178
Interest rate swaps, net of tax						2,511	2,511
Foreign currency translation, net of tax						2,587	2,587
Total comprehensive income							67,276
Issuance of common stock to employees	2,408	25	53,052				53,077
Repurchase of common stock	(3,959)	(40)	(106,193)				(106,233)
Issuance of restricted stock	195	2	4,830	(4,832)			(0)
Amortization of restricted stock				1,601			1,601
Tax effect from the exercise of non-qualified stock options			8,737				8,737
Balance at December 31, 2003	**20,988**	**$210**	**$ 273,378**	**$(6,564)**	**$221,109**	**$ 2,143**	**$ 490,276**

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
(in thousands)	**2003**	2002	2001
Operating activities			
Net income	**$ 62,178**	$ 54,661	$ 49,101
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income from property sales	**(35,336)**	(6,011)	(20,210)
Equity in (earnings) losses of unconsolidated senior living properties	**(1,161)**	(695)	1,169
Minority interests	**1,105**	160	769
Provision for bad debts	**6,541**	850	1,320
Provision for deferred income taxes	**24,964**	26,986	26,562
Depreciation and amortization	**16,406**	25,317	28,475
Amortization of financing costs and discount on long-term debt	**6,517**	5,292	3,488
Amortization of deferred compensation	**1,601**	688	—
Loss (gain) on early debt retirement	**—**	4,140	(861)
Changes in operating assets and liabilities:			
(Increase) decrease:			
Accounts receivable	**(25,516)**	(1,194)	(4,576)
Prepaid expenses and other current assets	**(17,038)**	(15,325)	(2,304)
Other assets	**(8,806)**	1,381	(2,523)
Increase (decrease):			
Accounts payable and accrued expenses	**5,821**	1,574	18,991
Deferred revenue	**(3,285)**	(174)	354
Other liabilities	**4,827**	1,167	1,730
Net cash provided by operating activities	**38,818**	98,817	101,485
Investing activities			
Proceeds from sale of properties	**132,364**	128,001	52,008
(Acquisition) sale of business and properties	**(93,407)**	—	450
Decrease (increase) in property and equipment, net	**128,151**	99,453	(98,046)
Increase in investments and notes receivable	**(60,240)**	(52,169)	(123,950)
Proceeds from investments and notes receivable	**140,395**	64,678	130,222
Decrease (increase) in restricted cash and cash equivalents	**7,281**	(6,065)	(6,196)
Contributions to investments in unconsolidated senior living properties	**(17,080)**	(21,963)	(7,006)
Net cash provided by (used in) investing activities	**237,464**	211,935	(52,518)
Financing activities			
Net proceeds from exercised options	**53,077**	11,034	9,116
Additional borrowings under long-term debt	**269,637**	392,731	400,735
Repayment of long-term debt	**(559,370)**	(569,167)	(444,440)
Net investment in minority interest	**(556)**	(750)	—
Financing costs paid	**(3,408)**	(6,858)	(6,977)
Repurchase of stock	**(106,233)**	(14,898)	—
Net cash used in financing activities	**(346,853)**	(187,908)	(41,566)
Net (decrease) increase in cash and cash equivalents	**(70,571)**	122,844	7,401
Cash and cash equivalents at beginning of period	**173,119**	50,275	42,874
Cash and cash equivalents at end of period	**$ 102,548**	$ 173,119	$ 50,275

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Presentation

Sunrise Senior Living, Inc. ("Sunrise" or the "Company") is a provider of senior living services in the United States, Canada and the United Kingdom. Founded in 1981, Sunrise began with a simple but innovative vision—to create an alternative senior living option that would emphasize quality of life and quality of care. As of December 31, 2003, Sunrise operated 373 open communities, including 361 communities in the United States, nine communities in Canada and three communities in the United Kingdom, with a total resident capacity of approximately 43,000. Sunrise communities offer a full range of personalized senior living services, from independent living, to assisted living, to care for individuals with Alzheimer's and other forms of memory loss, to nursing and rehabilitative care. Sunrise also develops senior living communities for itself, for joint ventures in which it retains an ownership interest and for third parties.

Sunrise was incorporated in Delaware on December 14, 1994. The consolidated financial statements include Sunrise's wholly owned subsidiaries that manage, own and develop senior living properties. In addition, Sunrise consolidates two non-wholly owned limited liability companies pursuant to the consolidation criteria under Generally Accepted Accounting Principles.

2. Significant Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Sunrise considers cash and cash equivalents to include currency on hand, demand deposits, and all highly liquid investments with a maturity of three months or less at the date of purchase.

Allowance for Doubtful Accounts

Sunrise provides an allowance for doubtful accounts on its outstanding receivables based on its collection history. Details of the allowance for doubtful accounts receivable are as follows (in thousands):

	December 31,		
	2003	2002	2001
Beginning balance	**$ 3,980**	$ 4,188	$3,655
Provision for bad debts	**6,541**	850	1,320
Accounts written off	**(3,389)**	(1,058)	(787)
Ending balance	**$ 7,132**	$ 3,980	$4,188

Property and Equipment

Property and equipment are recorded at the lower of cost or fair value and include interest and property taxes capitalized on long-term construction projects during the construction period, as well as other costs directly related to the development and construction of properties. Maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Property and equipment are reviewed for impairment whenever events or circumstances indicate that the asset's undiscounted expected cash flows are not sufficient to recover its carrying amount. Sunrise measures an impairment loss by comparing the fair value of the asset to its carrying amount. Fair value of an asset is calculated as the present value of expected future cash flows.

Construction in progress includes pre-acquisition costs and other direct costs related to acquisition, development and construction of properties, including certain direct and indirect costs of Sunrise's development subsidiary. If a project is abandoned, any costs previously capitalized are expensed.

Intangible Assets

Intangible assets relate primarily to the merger and acquisition of Marriott Senior Living Services and Karrington Health, Inc. in 2003 and 1999, respectively and are comprised of management contracts, leaseholds and costs in excess of assets acquired. Costs in excess of assets acquired represent costs of business acquisitions in excess of the fair value of identifiable net assets acquired. Management contracts and leaseholds are amortized using the straight-line method over the remaining contract term, ranging from 2 to 29 years.

Costs in excess of assets acquired are reviewed annually for impairment. Based on the results of this review, no charge for impairment was required in 2003. The carrying amounts of management contracts and leaseholds are reviewed for impairment when indicators of impairment are identified. If the review indicates that the intangible assets are not expected to be recoverable based on the undiscounted cash flows of the acquired assets over the remaining amortization periods, the carrying value of the intangible assets will be adjusted. The accounting for costs in excess of assets acquired changed effective January 1, 2002. See Impact of Changes in Accounting Standards.

Pre-Opening Costs

Costs incurred to initially rent properties are capitalized and amortized over 12 months. All other pre-opening costs are expensed as incurred.

Deferred Financing Costs

Costs incurred in connection with obtaining permanent financing for Company-owned properties are deferred and amortized over the term of the financing on a straight-line basis, which approximates the effective interest method.

Investments in Unconsolidated Senior Living Properties

At December 31, 2003, Sunrise owned non-controlling interests in 134 senior living properties, 14 of which were under development. Sunrise's interests, through limited liability companies and partnerships, generally range from 7% to 50%. Sunrise has 14 properties in which it owns less than 10%, 90 properties in which it owns between 10% and 20%, 28 properties in which it owns between 21% and 30% and 4 properties in which it owns more than 30%. Sunrise does not control these entities, as major business decisions require approval by the other majority partners or members. Additionally, for investments entered into subsequent to January 31, 2003, which are variable interest entities, the Company is not the primary beneficiary, as defined, in the investments. Accordingly, these investments are accounted for under the equity method. As such, the investments are recorded at cost and subsequently are adjusted for equity in net income (losses) and cash contributions and distributions. Sunrise eliminates profits on sales of services to ventures to the extent of its ownership interest. Sunrise recognizes interest income to the extent of the outside partners' interest on loans advanced to the ventures. Differences between the carrying value of investments and the underlying equity in net assets of the investee, excluding goodwill, are amortized on a straight line basis over the estimated useful life of the underlying properties. Sunrise's interests in accumulated losses of unconsolidated senior living properties are recorded below Sunrise's cost basis to the extent of other notes and advances to those unconsolidated senior living properties. For information on commitments or contingencies of partnerships or limited liability companies in which Sunrise is a general partner or managing member, see Note 16.

As of December 31, 2003, Sunrise's underlying equity in net assets of the investees exceeded the carrying value of investments in the net assets of unconsolidated senior living properties by $45 million.

Derivatives and Hedging Activities

Sunrise recognizes all of its derivative instruments as either assets or liabilities in the consolidated balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, Sunrise must designate the hedging instrument, based upon the exposure being hedged, as either a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported on the balance sheet and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. As of December 31, 2003, we had no derivative instruments.

Revenue Recognition

Operating revenue consists of management services revenue, resident fee revenue (including resident community fees), and realized gain upon sale of senior living properties. Resident fee revenue is recognized when services are rendered. Agreements with residents are generally for a term of one year and are cancelable by residents with thirty days notice. Management services revenue is comprised of revenue from management contracts and development contracts. Revenue from management contracts is recognized in the month in which it is earned in accordance with the terms of the management contract. Revenue from development contracts is recognized over the term of the respective development contracts using the percentage-of-completion method. Revenue from facility contract services is comprised of management services fees plus reimbursable expenses of properties operated with Sunrise's employees under long-term operating agreements and is recognized when services are rendered. Income from property sales is recognized upon consummation of the sale of properties, unless a portion of the sale is contingent upon future events or performance. Deferred gains are then recognized upon performance or resolution of the contingency.

Income Taxes

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

Stock-Based Compensation

Sunrise grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. Sunrise accounts for stock option grants using the intrinsic value method in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and accordingly recognizes no compensation expense for the stock option grants. In addition, Sunrise grants restricted stock to officers and other key executives. These grants vest over one to ten years. Unvested amounts are reflected in the consolidated balance sheet and represent the fair value of shares at the date of grant, which will be amortized as compensation expense over the period of vesting.

Pro forma information regarding net income and diluted earnings per share is required by SFAS No. 123, *Accounting for Stock-Based Compensation* and SFAS No.148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, and has been determined as if Sunrise had accounted for its employee stock options under the fair value method of these Statements. The fair value for these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for 2003, 2002 and 2001: risk-free interest rate of 3.6% to 5.4%; dividend yield of 0%; expected lives of 10 years; and volatility of 50.85% to 56.22%.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because Sunrise's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures below, the estimated fair value of the options is amortized to expense, net of taxes, over the options' vesting period. Sunrise's pro forma information follows (in thousands, except per share amounts):

	Year Ended December 31,		
	2003	2002	2001
Net income:			
As reported	**$ 62,178**	$ 54,661	$ 49,101
Less: Total stock-based employee compensation expense determined under fair-value method for all awards, net of tax effects	**(14,812)**	(14,076)	(12,642)
Pro forma	**$ 47,366**	$ 40,585	$ 36,459
Basic net income per share:			
As reported	**$ 2.92**	$ 2.44	$ 2.25
Pro forma	**$ 2.22**	$ 1.82	$ 1.67
Diluted net income per share:			
As reported	**$ 2.63**	$ 2.23	$ 2.08
Pro forma	**$ 2.05**	$ 1.70	$ 1.59

Continuing Care Agreements

Residents of Lifecare Communities are required to sign a continuing care agreement ("Care Agreement") with Sunrise. The Care Agreements stipulate, among other things, the amount of all entry fees and monthly fees, the type of residential unit being provided, and Sunrise's obligation to provide both health care and non-health care services. In addition, the Care Agreements provide Sunrise with the right to increase future monthly fees. The Care Agreements are terminated upon the receipt of a written termination notice from the resident or the death of the resident.

When the present value of estimated costs to be incurred under Care Agreements exceeds estimated revenues, the present value of such excess costs are accrued currently. The calculation assumes a future increase in the monthly revenue commensurate with the monthly cost. The calculation currently results in an expected positive net present value cash flow and, as such, no liability has been recorded in the accompanying consolidated financial statements.

The components of the entry fees for lifecare Communities are as follow:

a. Lifecare Bonds—This component is refundable to the resident or the resident's estate upon termination or cancellation of the Care Agreement. Lifecare Bonds are primarily non-interest bearing and, depending on the type of plan, are equal to either 100, 95, 90 or 50 percent of the total entry fee less any additional occupant lifecare fees. As these obligations are considered security deposits, interest is not imputed on these obligations in accordance with APB 21. Lifecare bonds amount to $26 million and $0 at December 31, 2003 and December 31, 2002, respectively.

b. Additional Occupant Lifecare Fee—This is a nonrefundable fee for each additional occupant in a residential unit.

c. Lifecare Fee—This component is nonrefundable and equals the total entry fee less the two components described in a. and b.

Third-Party Reimbursements

A portion of the revenues from health care services is attributable to patients whose bills are paid by Medicare or Medicaid under contractual arrangements. Medicare reimburses costs based on a Prospective Payment System ("PPS") for most of our communities. PPS does not require a provision for estimated Medicare and Medicaid settlements. There are no receivables for estimated third-party payer settlements at December 31, 2003. The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Management believes they are in compliance with all relevant government laws and regulations. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

Impact of Changes in Accounting Standards

On January 1, 2002, Sunrise adopted Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*. In accordance with the new rule, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually for impairment. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives. Diluted net income and diluted earnings per share would have been $55 million and $2.11 per share, if SFAS No. 142 had been applied to 2001.

On January 1, 2003, Sunrise adopted Statement of Financial Accounting Standards (SFAS) No. 145, *Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS 145 requires companies to no longer report gains and losses associated with the extinguishment of debt as a component of extraordinary gains and losses, net of tax. These gains and losses are required to be presented within the statement of income in appropriate segregated line items. As required by SFAS 145, the extraordinary loss recognized in the year ended December 31, 2002 of approximately $4 million ($2 million net of tax) for fees associated with the $92 million term loan and premium paid for the early redemption of the convertible notes has been reclassified to interest expense.

On January 1, 2003, Sunrise adopted Statement of Financial Accounting Standards Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"). FIN 45 requires companies to initially record at fair value guarantees meeting the characteristics described in this Interpretation, which is different from the general practice of recording a liability only when a loss is probable and reasonably estimable, as defined by FASB Statement No. 5, *Accounting for Contingencies*. The Interpretation also requires a guarantor to provide new disclosures for guarantees even if the likelihood of the guarantor's having to make payments under the guarantee is remote. The Interpretation's disclosure requirements are included in Note 16. The Interpretation's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The adoption of FIN 45 did not have a material impact on the consolidated financial position or results of operation of Sunrise.

On February 1, 2003, Sunrise adopted FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). Under this new Interpretation, companies are required to determine if they are the primary beneficiary of a variable interest entity. If they are the primary beneficiary, the variable interest entity must be consolidated. All companies with variable interests in variable interest entities created after January 31, 2003 must apply the provisions of the Interpretation as of the date the entity was created (immediately). Public companies with calendar year-end quarters with a variable interest in a variable interest entity created before February 1, 2003 must apply the provisions of this Interpretation as of March 31, 2004 in accordance with FIN 46 Revised.

Sunrise's joint ventures fall into one of three categories. First, Sunrise enters into development joint ventures whereby a third-party investor and Sunrise capitalize a joint venture to develop and operate senior living communities. Second, Sunrise and a third-party investor capitalize a joint venture to acquire an existing senior living property. Finally, as a part of Sunrise's sale long-term manage back program, Sunrise sells owned properties into a joint venture in which Sunrise holds a minority interest that is then capitalized by a third-party investor. These partnerships obtain non-recourse third-party debt. Sunrise does not have future requirements to contribute additional capital over and above the original capital commitments. All three types of joint ventures are established as real estate partnerships to own the underlying property. Sunrise will then enter into a long-term management contract to operate the property on behalf of the joint venture. Sunrise's total investment in these joint ventures is comprised of Sunrise's direct capital investment in these joint ventures and, when agreed to, subordinated debt provided and other short-term advances. As of December 31, 2003, this total investment was $157 million not including any guarantees provided to these joint ventures as described in Note 16. The realization of this investment is dependent upon the ongoing operations of the joint ventures. See Note 6 for operating results of the joint ventures.

Based on Sunrise's review of FIN 46, Sunrise has determined that there are three joint ventures in which Sunrise has an interest that are variable interest entities under FIN 46. Two of the variable interest entities are development joint ventures, which were established in 1999 and 2003 and contain five and two operating senior living communities, respectively. The other variable interest entity is an operating joint venture formed in 2000. Sunrise is not considered the primary beneficiary for any of these joint ventures and therefore will continue to account for these investments under the equity method of accounting. Sunrise's remaining joint venture interests are not variable interest entities under FIN 46 as, among other factors, there is adequate equity in the joint ventures to support expected operations, there is sufficient third party capital and no guarantees of returns on capital, and Sunrise would not be deemed the primary beneficiary in these ventures. We are in the process of determining the effect of FIN 46, as passed in December 2003, on these three variable interest entities. Sunrise's maximum exposure from these three entities was $28 million at December 31, 2003.

Reclassifications

Certain 2002 and 2001 balances have been reclassified to conform to the 2003 presentation.

Net cash provided by operating activities and net cash used in investing activities in the Consolidated Statements of Cash Flows for the year ended December 31, 2001 were reclassified from the amounts previously reported. In arriving at net cash provided by operating activities, net income is adjusted by non-cash items. In the previously reported cash flows from operating activities, Sunrise adjusted net cash from operating activities by the deferred income recognized during that year from property sales that occurred during that year and prior years. However, cash flows from operating activities should have been adjusted for deferred income recognized from property sales that occurred only during prior years because deferred income recognized in the current year from property sales that occurred in the current year is an operating cash item. In addition, overstating the deferred income recognized during that year from property sales in adjusting net cash from operating activities had the corresponding effect of understating the increase in property and equipment in adjusting net cash from investing activities because cash that should have been attributed to gain from property sales was instead attributed to the sale of property and equipment. Consequently, Sunrise's prior year presentation had the effect of understating Sunrise's net cash provided by operating activities for the year ended December 31, 2001 and correspondingly understating Sunrise's net cash used in investing activities for the year ended December 31, 2001. The year ended December 31, 2001 presentation has been reclassified to conform to the 2003 and 2002 presentation.

A reconciliation of the previously reported amounts to the reclassified amounts for the year ended December 31, 2001 is presented below (in thousands).

	Previously Reported	Reclassified	Currently Reported
Year Ended December 31, 2001:			
Operating activities			
Deferred income			
from property sales	$(50,266)	$ 30,056	$ (20,210)
Net cash provided			
by operating activities	71,429	30,056	101,485
Investing activities			
Increase in property			
and equipment, net	(67,990)	(30,056)	(98,046)
Net cash used			
in investing activities	(22,462)	(30,056)	(52,518)
Net Cash Flow Impact		$ 0	

3. Property, Equipment and Properties Held for Sale

Property, equipment and properties held for sale consist of the following (in thousands):

	December 31,		
	Asset Lives	**2003**	2002
Land and land improvements	10–15 yrs.	**$ 53,089**	$ 92,938
Building and building			
improvements	40 yrs.	**269,107**	461,487
Furniture and equipment	3–10 yrs.	**68,070**	71,598
		390,266	626,023
Less accumulated depreciation			
and amortization		**(60,563)**	(78,007)
		329,703	548,016
Construction in progress		**82,525**	88,900
		412,228	636,916
Less properties held for sale		**—**	(337,233)
Property and equipment, net		**$412,228**	$ 299,683

Depreciation expense was $13 million, $20 million and $22 million for the years ended December 31, 2003, 2002 and 2001, respectively.

4. Notes Receivable—Affiliates

Notes receivable plus accrued interest consist of the following (in thousands):

	December 31,	
	2003	2002
LLC Note III, interest accrues at 10.0%	**$ 16,920**	$ 17,861
LLC Note IV	**—**	14,322
LLC Note V	**—**	22,350
Note I with international joint venture	**—**	5,025
Note II with international joint venture,		
interest accrues at 12.5%	**14,386**	17,195
Note III with international joint venture,		
interest accrues at 12.5%	**460**	407
Note IV partner loan with international		
joint venture, interest accrues at 15.0%	**9,369**	—
Note V with international joint venture,		
imputed interest rate of 4.37%	**870**	—
LLC Note VI, revolving credit agreement,		
interest accrues at 10.0%	**12,865**	—
ADG Note	**—**	593
AMB Note	**—**	570
Credit facility	**—**	1,075
Promissory Note I	**—**	306
Promissory Note II	**—**	3,992
Promissory Note III,		
interest accrues at 8.0%	**280**	260
Promissory Note IV, interest accrues		
at higher of 6% or LIBOR plus 3.0%	**2,681**	2,717
Promissory Note V,		
interest accrues at 7.5%	**4,325**	—
Promissory Note VI, interest		
accrues at LIBOR plus 2.5%	**1,304**	—
Promissory Note VII, interest		
accrues at LIBOR plus 2.5%	**1,041**	—
Promissory Note VIII, revolving credit		
agreement, interest accrues at 15.0%	**1,591**	—
Promissory Note IX,		
interest accrues at 8.0%	**1,700**	—
Promissory Note X, interest		
accrues at LIBOR plus 3.5%	**2,132**	—
Promissory Note XI, credit line, interest		
accrues at LIBOR plus 3.0%	**7,172**	—
Other notes receivable	**257**	619
	77,353	87,292
Current maturities	**(28,976)**	(10,180)
	$ 48,377	$ 77,112

In March 1999, Sunrise jointly formed a limited liability company ("LLC III") in which Sunrise owns a 9% minority interest. The purpose of LLC III is to develop, construct and own senior living properties. Sunrise loaned LLC III $16 million ("LLC Note III") to partially finance the initial development and construction of five properties. All five properties were completed and open at December 31, 2003. The LLC Note III is secured by the properties and is subordinated to other lenders of LLC III. The principal amount of the loan and accrued interest were due on July 1, 2002. Sunrise extended the maturity date of this note to June 2004 for any amounts outstanding at July 1, 2002. During 2003, Sunrise received payments of $2 million. See Note 18 Related-Party Transactions, Joint Ventures.

In March 1999, Sunrise jointly formed a limited liability company ("LLC IV") in which Sunrise owns a 9% minority interest. The purpose of LLC IV is to develop, construct and own senior living properties. Sunrise loaned LLC IV $6 million ("LLC Note IV") to partially finance the initial development and construction of six properties. In December 1999, Sunrise and LLC IV amended the LLC Note IV to increase the loan by $10 million. All six properties were completed and open at December 31, 2002. The LLC Note IV was secured by the properties and was subordinated to other lenders of LLC IV. The principal amount of the loan and accrued interest were due on the earlier of December 31, 2006 or termination of the management agreement between the parties. The LLC Note IV, including accrued interest, was repaid in June 2003 when the joint venture partner's interest was sold in two separate transactions to two newly formed ventures. Sunrise has a 10% interest in the new joint ventures. See Note 18 Related-Party Transactions, Joint Ventures.

In December 2000, Sunrise jointly formed a limited liability company ("LLC V") with an unrelated third party in which Sunrise owns a 9% minority interest. The purpose of LLC V is to develop, construct and own senior living properties. Sunrise loaned LLC V $17 million ("LLC Note V") to partially finance the initial development and construction of five properties. All five properties were completed and open at December 31, 2002. The LLC Note V was secured by the properties and was subordinated to other lenders of LLC V. The principal amount of the loan and accrued interest were due originally on December 16, 2007. The LLC Note V, including accrued interest, was repaid in June 2003 when the joint venture partner's interest was sold in two separate transactions to two newly formed ventures. Sunrise has a 10% interest in the new joint ventures.

In 1998, Sunrise jointly formed a limited liability company ("International LLC") with an unrelated third party in which Sunrise owns a 7% minority interest. The purpose of International LLC is to develop, construct and own ten senior living properties in the United Kingdom and Canada. Nine of these properties were completed and open at December 31, 2002. Sunrise agreed to make available up to approximately $4 million ("Note I") to International LLC under a revolving credit arrangement to partially finance the development of a property in the United Kingdom. Interest on the first $3 million of advances made under Note I accrues at 12.0%. Interest on an additional $1 million of advances accrued at a variable rate (5.89% at May 31, 2003). In 2001, Sunrise received payments of $1 million. The outstanding principal and unpaid accrued interest were due in November 2001. However, Note I was subordinated to a $17 million mortgage loan on the United Kingdom property that restricted the repayment of Note I until October 1, 2002. After that date, International LLC could repay Note I as long as it has met certain debt service criteria. International LLC has met the debt service criteria and repaid the principal balance plus accrued interest in 2003. See Note 18 Related-Party Transactions, Joint Ventures.

In 2001, Sunrise agreed to make funds available ("Note II") to International LLC to partially finance the initial development and construction of properties in the United Kingdom and Canada. Interest on amounts outstanding under Note II accrues at 12.5%. The Note II to Sunrise is subordinated to other lenders of the joint venture. Principal and interest become due as each property is sold by the joint venture. See Note 18 Related-Party Transactions, Joint Ventures.

In 2001, Sunrise jointly formed a limited liability partnership ("International LLC II") with the majority owner of International LLC in which Sunrise owns a 7% minority interest. The purpose of International LLC is to develop, construct and own senior living properties in the United Kingdom and Canada. In 2002, Sunrise agreed to make funds available ("Note III") to International LLC II to partially finance the initial development and construction of properties in the United Kingdom and Canada. Interest on amounts outstanding under Note III accrues at 12.5%. The Note III to Sunrise is subordinated to other lenders of the joint venture. Principal and interest become due as each property is sold by the joint venture. See Note 18 Related-Party Transactions, Joint Ventures.

In 2003, Sunrise approved a Partner Loan ("Note IV") to the majority owner of International LLC II to partially finance the initial development and construction of properties in the United Kingdom and Canada. Interest on amounts outstanding under Note IV accrues at 15.0%. Principal and interest, per agreement, is due currently. See Note 18 Related-Party Transactions, Joint Ventures.

In 2002, Sunrise jointly formed a limited liability partnership ("International LLC III") with the majority owner of International LLC in which Sunrise owns a 20% minority interest. The purpose of International LLC is to develop, construct and own senior living properties in the United Kingdom and Germany. In May 2002, Sunrise approved a Partner Loan ("Note V") to the majority owner of the International LLC III to partially finance the initial development and construction of properties in the United Kingdom and Germany. Interest on amounts outstanding under Note V accrues at imputed interest rate of 4.37%. Principal and interest become due as each property is sold by the joint venture.

In December 2002, Sunrise jointly formed a limited liability company ("LLC VI") in which Sunrise owns a 20% minority interest. The purpose of LLC VI is to develop, construct and own senior living properties. Sunrise agreed to loan LLC VI up to $20 million ("LLC Note VI") through a revolving credit agreement to partially finance the initial development and construction of fourteen properties. Repayment is expected from funding of the other lenders. Six properties were completed and open and eight were under construction at December 31, 2003. Interest accrues at 10%. The LLC Note VI is secured by the properties and is subordinated to other lenders of LLC VI. The advanced principal amount of the loan and accrued interest are due on the earlier of December 28, 2010 or termination of the management agreement between the parties.

In January 1999, a property in which Sunrise had a controlling interest accepted a $500,000 promissory note ("ADG Note") from its minority owner. The ADG Note accrued interest at 10% per annum and was due annually beginning February 22, 2000. The principal balance plus accrued and unpaid interest were due originally on February 22, 2009. The ADG Note, including accrued interest, was repaid in September 2003 when the controlling interest was acquired by a third party.

In 2001, a property, in which Sunrise had a controlling interest, accepted a $500,000 promissory note ("AMB Note") from its minority owner. The AMB Note accrued interest at 8% per annum and was due annually beginning March 2002. The principal balance plus accrued and unpaid interest were due in March 2010. The AMB Note, including accrued interest, was repaid in September 2003 when the controlling interest was acquired by a third party.

In 2001, Sunrise agreed to make available up to approximately $3 million ("Credit Facility") to the owner of a property that Sunrise manages under a management contract. Interest accrues at LIBOR plus 3.5% per annum. Principal and accrued and unpaid interest were due at the earlier date of the third party's full repayment of its mortgage or September 2003. The Credit Facility principal and accrued and unpaid interest were repaid during 2003.

In December 2001, Sunrise accepted a promissory note in the amount of $400,000 ("Promissory Note I") from a joint venture partner to finance a portion of the acquisition of one-half of Sunrise's ownership interest in a property. Interest accrues at 10% per annum. Principal and interest were due monthly until the promissory note is paid in full in January 2007. The Promissory Note I principal and interest were repaid, in advance, during 2003.

In May 2001, Sunrise accepted a promissory note in the amount of $4 million ("Promissory Note II") from Sunrise Assisted Living Foundation, Inc. ("SALF"), a not-for-profit organization that operates two schools. The Promissory Note II pertains to a school operated on an undivided parcel on which Sunrise operates an assisted living property and is secured by an interest in the whole parcel. Interest accrued at LIBOR plus 2.75% per annum. Principal and interest payments were made monthly based on a twenty-five year amortization schedule at the rate of 6.689%. The unpaid principal balance plus accrued and unpaid interest were due in January 2003. Sunrise extended the maturity date of this note to April 2003. The Promissory Note II principal and interest were repaid during 2003. See Note 18, Related Party Transactions, Sunrise Assisted Living Foundation.

In February 2002, Sunrise accepted a secured promissory note in the amount of $250,000 ("Promissory Note III") from an unrelated third party. The Promissory Note III pertains to a development and management rights agreement for properties in Georgia and Missouri. Interest accrues at 8% per annum. Principal and accrued interest are due March 2007.

In March 2002, Sunrise accepted a promissory note in the amount of $3 million ("Promissory Note IV") from a limited partnership in which Sunrise has a 20% ownership interest. The Promissory Note IV is subordinated to other lenders of the limited partnership. Interest accrues at the higher of 6% or LIBOR plus 3% per annum. Monthly interest payments start on June 1, 2002 and continue through March 1, 2003. Monthly principal and interest payments start on April 1, 2003 and continue through April 1, 2004. Any unpaid principal balance plus accrued and unpaid interest are due on April 1, 2004.

In March 2003, Sunrise accepted a promissory note in the amount of $4.8 million ("Promissory Note V") from a third party. The Promissory Note V is subordinated to other lenders of the third party. Interest accrues at 7.5% per annum. Monthly interest payments start on April 20, 2003 and continue through February 20, 2004. Monthly principal and interest payments start on February 20, 2004 and continue through February 20, 2033. Any unpaid principal balance plus accrued and unpaid interest are due on February 20, 2033.

In June 2003, Sunrise accepted a promissory note in the amount of $2.1 million ("Promissory Note X") from a limited liability company in which Sunrise has a 10% ownership interest. Interest accrues at LIBOR plus 3.5% per annum. Monthly interest payments start on July 1, 2003 and continue through June 1, 2013. Principal and any accrued and unpaid interest are due and payable on July 1, 2013.

In September 2003, Sunrise accepted a promissory note for a credit line in the amount of $7.9 million ("Promissory Note XI") from a limited liability company in which Sunrise has a 10% ownership interest. Sunrise paid an advance of principal of $7.1 million on the credit line during 2003. Interest accrues at LIBOR plus 3% per annum. Principal and any accrued and unpaid interest are due and payable on September 30, 2008 unless the maturity date is extended. There is an option for a five year extension to September 30, 2013.

In September 2003, Sunrise accepted a secured promissory note in the amount of $1.3 million ("Promissory Note VI") from a limited liability company in which Sunrise has a 10% ownership interest. Interest accrues at LIBOR plus 2.5% per annum. Monthly interest payments start on October 1, 2003 and continue through September 1, 2013. Principal and any accrued and unpaid interest are due and payable on October 1, 2013.

In September 2003, Sunrise accepted a promissory note in the amount of $1 million ("Promissory Note VII") from a limited liability company in which Sunrise has a 10% ownership interest. Interest accrues at LIBOR plus 2.5% per annum. Monthly interest payments start on October 1, 2003 and continue through September 1, 2013. Principal and any accrued and unpaid interest are due and payable on October 1, 2013.

In November 30, 2001, Sunrise accepted a promissory note for a revolving credit agreement in the amount of $3 million ("Promissory Note VIII") from a company in which Sunrise has a 3% ownership interest. Interest accrues at 15% per annum. Monthly interest payments start on the first calendar day of the month following the first initial draw under the terms of the revolving credit agreement and continue through September 30, 2007. The first draw on the credit agreement was for $1.5 million during September 2003. Principal and any accrued and unpaid interest are due and payable on September 30, 2007.

In December 2003, Sunrise accepted a promissory note in the amount of $1.7 million ("Promissory Note IX") from a partner of a jointly formed limited liability company in which Sunrise has a 10% interest. Interest accrues at 8% per annum. Interest is compounded quarterly. Principal and accrued interest are due and payable on the maturity date. The maturity date is the earlier of the date the borrower sells, transfers or assigns all or any portion of its membership interest in the company, the date the company sells substantially all of its assets, or June 30, 2007.

Sunrise believes the net carrying amount of the notes receivable approximates market value at December 31, 2003 and 2002.

Sunrise recorded interest income on these notes from related parties of $7 million, $9 million and $9 million during 2003, 2002 and 2001, respectively.

5. Intangibles and Other Assets

Intangible assets consist of the following (dollars in thousands):

	December 31,		Estimated
	2003	2002	Useful Life
Management contracts, less accumulated amortization of $2,764 and $1,630	**$ 76,365**	$ 5,759	2–29 years
Leaseholds, less accumulated amortization of $1,960 and $1,503	**6,030**	6,381	19 years
	$ 82,395	$12,140	
Costs in excess of assets acquired, less accumulated amortization of $2,179 and $2,179	**$106,139**	$32,749	

Amortization expense was $3 million, $5 million and $7 million for the years ended December 31, 2003, 2002 and 2001, respectively. Amortization expense is expected to be approximately $5 million in each of the next five years.

Other assets consist of the following (in thousands):

	December 31,	
	2003	2002
Restricted cash	**$23,904**	$18,326
Deferred financing costs less accumulated amortization of $7,336 and $14,974	**6,380**	10,367
Pre-rental costs less accumulated amortization of $3,338 and $9,331	**625**	2,793
Other	**14,411**	1,377
	$45,320	$32,863

Restricted cash consists of real estate tax escrows, operating reserves and capital reserves related to Sunrise's debt agreements and resident deposits.

6. Transactions with Unconsolidated Entities

Included in prepaid expenses and other current assets are net receivables from related unconsolidated partnerships or limited liability companies of $15 million and $19 million as of December 31, 2003 and 2002, respectively. Included in other current liabilities are net payables to unconsolidated partnerships or limited liability companies of $1 million and $1 million as of December 31, 2003 and 2002, respectively. Net receivables from unconsolidated partnerships or limited liability companies relate primarily to management activities. Also, see Note 4 for a discussion of notes receivable from affiliates.

Summary financial information for unconsolidated entities (7% to 50% owned) accounted for by the equity method is as follows (in thousands):

	December 31,		
	2003	2002	2001
Assets, principally property and equipment	**$1,915,403**	$1,438,034	$858,079
Liabilities, principally long-term debt	**1,343,956**	1,003,627	640,551
Equity	**571,447**	434,407	217,528
Revenues	**420,520**	271,348	169,453
Net income (loss)	**14,353**	(3,158)	(11,289)

The 2002 net loss amount has been adjusted to conform to the current year presentation for the exclusion of net loss of certain entities for which Sunrise provides accounting support but does not have an ownership interest. No other disclosure balances were affected by this adjustment. The previously reported net loss for the year ended December 31, 2002 was $23,293.

Total management services revenue from related unconsolidated entities was $300 million, $161 million and $85 million for the years ended December 31, 2003, 2002 and 2001, respectively.

7. Long-Term Debt

Long-term debt consists of the following (in thousands):

	December 31, 2003	2002
5¼% convertible subordinated notes due 2009	**$120,000**	$125,000
Syndicated revolving credit facility	—	108,915
Multi-property blanket first mortgage	—	78,354
Revolving credit facilities	—	34,852
Life care endowment obligations	**24,869**	—
Other mortgages and notes payable	**78,121**	109,848
	222,990	456,969
Current maturities	**(22,162)**	(29,415)
	$200,828	$427,554

On June 6, 1997, Sunrise issued and sold $150 million aggregate principal amount of 5½% convertible subordinated notes due 2002. The convertible notes bore interest at 5½% per annum payable semiannually on June 15 and December 15 of each year, beginning on December 15, 1997. The conversion price was $37.1875 (equivalent to a conversion rate of 26.89 shares per $1,000 principal amount of the convertible notes). The convertible notes were redeemable at the option of Sunrise commencing June 15, 2000, at specified premiums. On September 14, 2001, Sunrise's Board of Directors authorized the repurchase of up to an additional $50 million of its outstanding 5.5% subordinated convertible notes (See Note 8). During 2001, Sunrise repurchased $42 million face value of the convertible notes, resulting in interest income of $1 million.

In February 2002, Sunrise redeemed the remaining $108 million 5½% convertible notes at a redemption price of 101.1% of the principal amount, plus accrued and unpaid interest from the proceeds of a new term loan (see below). The aggregate redemption price was $110 million. None of the convertible notes were converted into common stock. As a result of the redemption in 2002 from proceeds of other long-term borrowings, the convertible notes were classified as long-term at December 31, 2001.

In January 2002, Sunrise obtained a term loan for $92 million to be used, in part, to pay off the remaining $108 million of its outstanding 5½% subordinated convertible notes. The term loan was collateralized by 14 properties, accrued interest at LIBOR plus 6% and matured in May 2004, subject to a six-month extension option. In February 2002, Sunrise drew $92 million on the term loan and repaid it the same day. Sunrise recorded interest expense of $4 million during the first quarter of 2002 for fees associated with the $92 million term loan and the premium paid for the early redemption of the convertible notes.

In January 2002, Sunrise issued and sold $125 million aggregate principal amount of 5¼% convertible subordinated notes due February 1, 2009. The convertible notes bear interest at 5¼% per annum payable semiannually on February 1 and August 1 each year beginning on August 1, 2002. The conversion price is $35.84 (equivalent to a conversion rate of 27.9018 shares per $1,000 principal amount of the convertible notes). The notes are subordinated to Sunrise's existing and future senior indebtedness. During 2003, Sunrise repurchased $5 million principal amount of the convertible notes. The remaining $120 million convertible notes are redeemable at the option of Sunrise commencing February 5, 2006, at specified premiums. The holders of the convertible notes may require Sunrise to repurchase the convertible notes upon a change of control of Sunrise as defined in the convertible notes. In February 2002, $92 million of the net proceeds from the 5¼% convertible notes were used to pay off the term loan.

A subsidiary of Sunrise obtained a syndicated revolving credit facility for $400 million which was used for general corporate purposes, including the continued construction and development of senior living properties. Sunrise guaranteed the repayment of all amounts outstanding under this credit facility. The credit facility was secured by cross-collateralized first mortgages on the real property and improvements and first liens on all assets of the subsidiary, consisting of 23 properties. In June 2001, Sunrise refinanced its syndicated revolving credit facility and reduced it from $400 million to up to $300 million. The maturity date was extended from July 2002 to June 2004 and the interest rate increased from LIBOR plus 1.75% to LIBOR plus 2.00%. In December 2002, Sunrise reduced its syndicated revolving credit facility to $265 million. Sunrise paid commitment fees of 0.25% on the unused balance of the credit facility.

During the third quarter of 2003, Sunrise closed on a $200 million corporate credit facility with a syndicate of banks. The facility has an initial term of three years with an extension option. The corporate credit facility accrues interest at LIBOR plus 1.75% to 3.00% (3.37% at December 31, 2003). Proceeds were used for general corporate purposes, including investments, acquisitions and the refinancing of existing debt. Consistent with Sunrise's transformation to a management services company, the facility is not secured by real estate and replaces the $265 million syndicated revolving credit facility. Sunrise pays commitment fees of 0.25% to 0.45% on the unused balance of the credit facility. There were no advances outstanding under this credit facility as of December 31, 2003.

As of December 31, 2002, Sunrise had a $79 million multi-property blanket first mortgage that was collateralized by a blanket first mortgage on all assets of a subsidiary of Sunrise, consisting of 14 properties. The multi-property blanket first mortgage, as modified in May 2001, was scheduled to mature on May 31, 2004, subject to optional extensions, and had a fixed rate of interest equal to 8.20%. On September 30, 2003, proceeds from the sale of 10 of the 14 properties securing the debt were used to pay off the loan.

In November 2001, Sunrise entered into a $60 million revolving credit facility, expandable to $100 million. The revolving credit facility matures in November 2006, subject to a five-year extension, accrues interest at LIBOR plus 1.20% (2.32% at

December 31, 2003) and is collateralized by senior living properties. The revolving credit facility may be converted to a fixed rate facility at any time during the term. Sunrise pays commitment fees of 0.13% on the unused portion of the credit facility. In September 2003, Sunrise reduced its revolving credit facility to $16 million. At December 31, 2003, the collateral of the revolving credit facility consisted of three properties and $16 million was outstanding.

In December 2002, Sunrise entered into an $18 million revolving credit facility. The revolving credit facility matures in January 2005, accrues interest at LIBOR plus 2.50% (3.62% at December 31, 2003) and is collateralized by senior living properties. In June 2003, Sunrise reduced its revolving credit facility to $11 million due to the sale of one property that served as collateral. At December 31, 2003, the collateral of the revolving credit facility consisted of seven properties and no amounts were outstanding.

In March 2003, Sunrise entered into a $50 million unsecured revolving credit facility. The revolving credit facility was scheduled to mature in one year and accrued interest at LIBOR plus 2.50%. Sunrise paid commitment fees of 0.10% on the unused portion of the credit facility. In September 2003, the credit facility was terminated as part of the closing of the $200 million corporate credit facility.

In December 2002, Sunrise received a commitment for a $17 million credit facility. The credit facility matures in February 2005, subject to a one-year extension, accrues interest at LIBOR plus 3.25% (4.37% at December 31, 2003) subject to a minimum of 5.75% and is collateralized by three senior living properties. In June 2003, Sunrise reduced its revolving credit facility to $2 million due to the sale of two properties that served as collateral. At December 31, 2003, the collateral of the revolving credit facility consisted of one property and no amounts were outstanding.

In January 2003, Sunrise entered into a $20 million revolving credit facility. The revolving credit facility matured in January 2005, was subject to a one-year extension, accrued interest at Prime subject to a minimum of 5%, and was collateralized by five senior living properties. In November 2003, Sunrise terminated the credit facility.

In December 2002, Sunrise received commitments for mortgages on two senior living properties for an aggregate amount of $16 million. The mortgages mature in January 2005 are subject to a one-year extension. Interest accrues at LIBOR plus 2.50% (3.62% at December 31, 2003) and the mortgages are cross collateralized by two senior living properties. In September 2003, Sunrise reduced its revolving credit facility to $9.2 million due to the sale of one property that served as collateral. At December 31, 2003, the collateral of the revolving credit facility consisted of one property and no amounts were outstanding.

In June 2003, Sunrise received commitments for mortgages on two senior living properties for an aggregate amount of $2.4 million. The mortgages mature 1.5 year from closing, are subject to a one-year extension, accrue interest at LIBOR plus 2.50% (3.67% at December 31, 2003) and are cross collateralized by two senior living properties. At December 31, 2003, no amounts were outstanding.

As part of the MSLS acquisition in March 2003, Sunrise assumed $25 million of life care endowment obligations related to five communities. The obligations do not have a maturity date and the majority of them are expected to be refinanced with proceeds from the issuance of new endowment obligations as new residents enter the communities. As of December 31, 2003, $26 million of life care obligations were outstanding.

The other mortgages and notes payable relate primarily to 13 properties whereby outstanding balances are collateralized by the total assets of the respective property. Payments of principal and interest are made monthly. Interest rates range from 2.50% to 6.87% with remaining maturities ranging from less than one year to 20 years. These other mortgages and notes payable have total borrowings of $62 million as of December 31, 2003.

During 2001, Sunrise entered into five interest rate swap agreements whereby $125 million of advances outstanding on Sunrise's variable LIBOR based revolving construction credit facility bear interest at a fixed rate. The maturity dates of the swap agreements ranged from June 2003 to June 2004. In December 2002, Sunrise paid $400,000 to terminate one of the five interest rate swap agreements. In 2003, Sunrise paid $3 million to terminate the remaining four interest rate swap agreements. For the year ended December 31, 2003, Sunrise recognized $2 million in interest expense related to the amortization of the swap balance in accumulated other comprehensive income. Sunrise also wrote off $2 million of the swap balance in accumulated other comprehensive income as debt associated with the swap was repaid as part of the property sale transactions closed in the second and third quarters of 2003. As of December 31, 2003, Sunrise had a zero balance in accumulated other comprehensive income related to the terminated swap agreements.

There are various financial covenants and other restrictions in Sunrise's debt instruments, including provisions which: (1) require it to meet certain financial tests. For example, Sunrises' $200 million line of credit requires Sunrise not to exceed certain leverage ratios, to maintain certain fixed coverage ratios and to have a consolidated net worth of at least $387 million as adjusted each quarter and to meet other financial ratios. These tests are administered on a monthly or quarterly basis, depending on the covenant; (2) require consent for changes in control of Sunrise; and (3) restrict the ability of Sunrise and Sunrise's subsidiaries to borrow additional funds, dispose of assets or engage in mergers or other business combinations without lender consent.

Sunrise's syndicated revolving credit facility contains a cross-default provision pursuant to which a default on other indebtedness by Sunrise or any of its consolidated subsidiaries under the credit facility could result in the ability of the lenders to declare a default and accelerate the indebtedness under the credit facility.

As of December 31, 2003, Sunrise was in compliance with all of its debt covenants.

Principal maturities of long-term debt as of December 31, 2003 are as follows (in thousands):

2004	$ 22,162
2005	20,452
2006	29,998
2007	9,985
2008	3,624
Thereafter	136,769
	$222,990

Interest paid totaled $23 million, $36 million and $42 million in 2003, 2002 and 2001, respectively. Interest capitalized was $3 million, $7 million and $7 million in 2003, 2002 and 2001, respectively.

As of December 31, 2003, Sunrise has $41 million in unused letters of credit that have been pledged for the benefit of certain lending institutions and municipalities. The letters of credit expire within two years.

8. Stockholders' Equity

In July 2002, Sunrise announced that its Board of Directors authorized the repurchase of outstanding shares of Sunrise common stock up to an aggregate purchase price of $50 million over the next 12 months. In 2002, Sunrise purchased 581,400 shares at an average price of $25.62 per share through open-market purchases. In May 2003, Sunrise's Board of Directors expanded the repurchase program to an aggregate of $150 million to repurchase outstanding shares of common stock of Sunrise and/or its outstanding 5¼% convertible subordinated notes due 2009. In 2003, Sunrise purchased another 3,959,400 shares at an average price of $26.83 bringing the total shares purchased through December 31, 2003 to 4,540,800 shares at an average price of $26.68. Additionally, in 2003, Sunrise purchased $5 million of its convertible debt.

9. Stock Option Plans

Sunrise has stock option plans providing for the grant of incentive and nonqualified stock options to employees, directors, consultants and advisors. At December 31, 2003, these plans provided for the grant of options to purchase up to 9,898,910 shares of common stock. The option exercise price and vesting provisions of the options are fixed when the option is granted. The options expire ten years from the date of grant and generally vest over a four-year period. The option exercise price is not less than the fair market value of a share of common stock on the date the option is granted.

On April 25, 1996, the Board of Directors adopted the 1996 Directors' Stock Option Plan (the "Directors' Plan"). Any director who was a member of the Board of Directors but not an officer or employee of Sunrise or any of its subsidiaries (other than the persons elected as director representatives of the holders of Series A Preferred Stock) was eligible to receive options under the Directors' Plan. In March 2000, the Directors' Plan was terminated. An aggregate of 75,000 shares of common stock is reserved for issuance under existing option agreements. The option exercise price is not less than the fair market value of a share of common stock on the date the option was granted. The period for exercising an option begins six months after the option was granted and generally ends ten years from the date the option was granted. Options granted under the Directors' Plan vested immediately. All options granted under the Directors' Plan are non-incentive stock options. As of December 31, 2003, 75,000 options remained outstanding under the plan.

A summary of Sunrise's stock option activity, and related information for the years ended December 31 are presented below:

	2003		2002		2001	
	Shares (000)	**Weighted-Average Exercise Price**	Shares (000)	Weighted-Average Exercise Price	Shares (000)	Weighted Average Exercise Price
Outstanding—beginning of year	**6,411**	**$22.07**	6,168	$21.52	5,959	$21.33
Granted	**607**	**19.32**	1,049	22.90	1,205	22.27
Exercised	**(2,337)**	**21.64**	(568)	17.62	(570)	15.73
Canceled	**(354)**	**24.33**	(238)	22.24	(426)	28.98
Outstanding—end of year	**4,327**	**21.63**	6,411	22.07	6,168	21.52
Options exercisable at year-end	**2,576**		3,572		3,030	
Weighted-average fair value of options granted during the year	**$16.61**		$18.15		$16.16	

The following table summarizes information about stock options outstanding at December 31, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding (000)	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable (000)	Weighted Average Exercise Price
$ 3.00–$ 8.00	30	1.6	$ 3.33	30	$ 3.33
8.01– 20.00	1,137	6.4	16.32	737	16.25
20.01– 25.63	1,832	6.1	24.15	1,249	24.38
25.64– 44.56	1,328	7.4	28.60	560	30.80
	4,327			2,576	

10. Restricted Stock

The Company's stockholders approved the 2002 Stock Option and Restricted Stock plan at the Company's annual meeting of stockholders held on May 17, 2002. On March 21, 2002 and February 25, 2003, a total of 148,100 and 3,500 shares, respectively, of restricted stock were granted to Paul J. Klaassen, Chairman of the Board and Chief Executive Officer, Thomas B. Newell, President and Larry Hulse, Chief Financial Officer.

The Company's stockholders approved the 2003 Stock Option and Restricted Stock plan at the Company's annual meeting of stockholders held on May 12, 2003. On May 12, 2003 and September10, 2003 a total of 192,400 shares of restricted stock were granted to Paul J. Klaassen, Chairman of the Board and Chief Executive Officer, Larry Hulse, Chief Financial Officer, Tiffany Tomasso, Chief Operating Officer, Chris Slavin, Chief Investment Officer, and other key executives.

These grants vest over one to ten years. Unvested amounts are reflected in the consolidated balance sheets and represent the fair value of shares at the date of grant, which will be amortized as compensation expense over the period of vesting. During 2003 and 2002, Sunrise recognized $1.6 and $0.7 million in compensation expense, respectively. As of December 31, 2003, 20,997 of the 344,000 shares of restricted stock were vested.

11. Stockholder Rights Agreement

The Board of Directors adopted a Stockholders Rights Agreement ("Rights Agreement") effective April 25, 1996, as amended. All shares of common stock issued by Sunrise between the date of adoption of the Rights Agreement and the Distribution Date (as defined below) have rights attached to them. The rights expire ten years after adoption of the Rights Agreement. Each right, when exercisable, entitles the holder to purchase one one-thousandth of a share of Series C Junior Participating Preferred Stock at a price of $85.00 (the "Purchase Price"). Until a right is exercised, the holder thereof will have no rights as a stockholder of Sunrise.

The rights initially attach to the common stock. The rights will separate from the common stock and a distribution of rights certificates will occur (a "Distribution Date") upon the earlier to occur of (1) ten days following a public announcement that a person or group (an "Acquiring Person") has acquired, or obtained the right to acquire, beneficial ownership of 20% or more of the outstanding shares of common stock (the "Stock Acquisition Date") or (2) ten business days (or such later date as the Board of Directors may determine) following the commencement of a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a person of 20% or more of the outstanding shares of common stock. However, neither Paul J. Klaassen nor Teresa M. Klaassen (nor their affiliates, associates and estates), each of whom, as of the date of adoption of the Rights Agreement, beneficially owned in excess of 20% of the outstanding shares of common stock, will be deemed an "Acquiring Person," unless they acquire an additional 2% of the common stock which was outstanding at the time of completion of Sunrise's initial public offering.

In general, if a person becomes the beneficial owner of 20% or more of the then outstanding shares of common stock, each holder of a right may exercise the right by purchasing common stock having a value equal to two times the Purchase Price. If at any time following the Stock Acquisition Date (1) Sunrise is acquired in a merger or other business combination transaction in which it is not the surviving corporation (other than a merger which follows an offer described in the preceding paragraph), or (2) 50% or more of Sunrise's assets or earning power is sold or transferred, each holder of a right shall have the right to receive, upon exercise, common stock of the acquiring company having a value equal to two times the Purchase Price. The Board of Directors of Sunrise generally may redeem the rights at a price of $.005 per right at any time until ten days after an Acquiring Person has been identified as such.

12. Net Income Per Common Share

The following table summarizes the computation of basic and diluted net income per common share amounts presented in the accompanying consolidated statements of operations (in thousands, except per share amounts):

	Year Ended December 31,		
	2003	2002	2001
Numerator for basic net income per share:			
Net income	**$62,178**	$54,661	$49,101
Numerator for diluted net income per share:			
Net income	**$62,178**	$54,661	$49,101
Assumed conversion of convertible notes, net of tax	**4,584**	4,610	4,795
Diluted net income	**$66,762**	$59,271	$53,896
Denominator:			
Denominator for basic net income per common share-weighted average shares	**21,298**	22,357	21,825
Effect of dilutive securities:			
Employee stock awards	**624**	643	651
Convertible notes	**3,452**	3,552	3,476
Denominator for diluted net income per common share-weighted average shares plus assumed conversions	**25,374**	26,552	25,952
Basic net income per common share:			
Net income	**$ 2.92**	$ 2.44	$ 2.25
Diluted net income per common share:			
Net income	**$ 2.63**	$ 2.23	$ 2.08

Certain shares issuable upon the exercise of stock options or convertible notes have been excluded from the computation because the effect of their inclusion would be anti-dilutive. Options are included under the treasury stock method to the extent they are dilutive.

13. Acquisitions

On March 28, 2003, Sunrise completed its acquisition of all the outstanding stock of Marriott International, Inc.'s wholly owned subsidiary, Marriott Senior Living Services, Inc. (MSLS), which owns and operates senior independent full-service and assisted living properties. Sunrise paid approximately $92 million in cash to acquire all of the outstanding stock of MSLS. Sunrise also assumed approximately $29 million of working capital liabilities and other funding obligations as well as approximately $25 million of life care endowment obligations, the majority of which are expected to be refinanced with proceeds from the issuance of new endowment obligations as new residents enter the communities. Operations of MSLS are included in the consolidated income statement from March 28, 2003 to December 31, 2003.

The acquisition of MSLS was accounted for using the purchase method of accounting and the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values. The initial purchase price was allocated to assets acquired, including separately identifiable intangible assets, and liabilities assumed based on current valuations of assets and liabilities. Certain valuations are subject to adjustment as contingencies are resolved and additional information on certain estimates become available. Net working capital deficit was adjusted by approximately $5 million, costs in excess of assets acquired and transaction costs were adjusted by approximately $2 million each and land was adjusted by approximately $1 million during 2003 as additional information was obtained or finalization of working capital balances were determined. The purchase price values assigned to the major assets and liabilities are as follows:

Management contracts and leases, net	$63 million
Land	$22 million
Life care endowment obligations	$25 million
Net working capital deficit and other	$29 million
Costs in excess of assets acquired	$73 million
Transaction costs	$12 million

The portion of the purchase price allocated to management contracts and leases will be amortized into expense over the specific term of each individual management contract and lease acquired ranging from two to 29 years. Sunrise also assumed certain guarantees of MSLS and Marriott International, Inc. in the acquisition. See Note 16 for a description of those guarantees. The year ended December 31, 2003 includes $11 million in transition expenses related to this acquisition which have been reflected in general and administrative expenses.

The following unaudited pro forma information presents the results of operations of Sunrise for the years ended December 31, 2003 and 2002, respectively, as if the acquisition of MSLS had taken place as of January 1, 2002.

	Year Ended December 31, 2003	Year Ended December 31, 2002
Revenue	**$1,380,291**	$1,273,870
Net income	**$ 61,637**	$ 52,553
Basic earnings per share	**$ 2.89**	$ 2.35
Diluted earnings per share	**$ 2.61**	$ 2.15

In June 2003, Sunrise acquired the remaining majority interest, ranging from 50 to 81 percent, in seven senior living properties in which it previously maintained a minority ownership interest. The majority interest holder was a not-for-profit entity. In order to acquire the remaining ownership interest, Sunrise assumed approximately $21 million in debt and paid approximately $2 million in cash. These properties were previously accounted for using the equity method of accounting. The acquisition was accounted for using the purchase method of accounting. Sunrise allocated its current investment carrying value and purchase price to the assets acquired and liabilities assumed. The initial purchase price values assigned to the major assets and liabilities are $35 million for property, $5 million for land, $3 million for furniture, fixtures and equipment, and $21 million for debt. The results of operations for these properties are reflected in Sunrise's consolidated financial statements from June 30, 2003 forward. The acquisition of these interests was immaterial to the pro forma results.

14. Dispositions

In 2000, Sunrise announced its intention to sell selected owned properties as a normal part of its operations and retain long-term management contracts and, in many cases, minority equity interests in the properties. Sunrise has performed under its sale/long-term manage back program by selling some properties 100% to third-parties and retaining a long-term management contract and selling some properties to joint ventures in which it has a minority ownership interest, generally ranging from 10% to 25%. If Sunrise sells 100% of a property to a third-party owner, it recognizes a gain from the sale for the difference between the purchase price and the book value of the property, less the costs to sell. Sunrise also removes the book value of the property from the "Property and equipment" line item on the consolidated balance sheet and removes from liabilities any debt repaid or assumed by the new owner in the transaction. If Sunrise sells a property to a joint venture in which it has a minority ownership interest, Sunrise will recognize as a gain from the sale the difference between the purchase price and the book value of the property, less the costs to sell, adjusted to reflect only the gain associated with the third-party ownership in the joint venture. Sunrise does not record a gain on the portion of the sale associated with its remaining ownership in the joint venture. Sunrise also records, at historical cost basis, its remaining ownership of the property sold and debt assumed by the joint venture as an investment.

In June 2000, Sunrise completed the sale of three properties for an aggregate sales price of $44 million to a real estate venture company in which Sunrise owns a 25% interest. Sunrise realized $13 million in gain, subject to certain contingencies being met, of which $2 million and $11 million was recognized in 2001 and 2000, respectively. In September 2000, Sunrise completed the sale of eight properties for an aggregate sales price of $111 million to the same venture company. The venture company assumed approximately $75 million of debt secured by the eight properties. Sunrise realized $26 million in gain, subject to certain contingencies being met, of which $13 million and $13 million was recognized in 2001and 2000, respectively. Sunrise continues to operate the properties under long-term operating agreements.

In December 2000, Sunrise completed the sale of two properties for an aggregate sales price of $28 million. Sunrise realized $9 million in gain, subject to certain contingencies being met, of which $1 million, $5 million and $2 million was recognized in 2002, 2001 and 2000, respectively. Sunrise continues to operate the properties under long-term operating agreements.

In February 2001, Sunrise completed the sale of nine properties for an aggregate sales price of $131 million to a limited partnership in which Sunrise owns a 25% interest. Sunrise realized $41 million in gain, subject to certain contingencies being met, of which, $1 million and $40 million was recognized during 2002 and 2001. Sunrise continues to operate the properties under long-term operating agreements.

In October 2001, Sunrise completed the sale of one property for an aggregate sales price of $17 million to a real estate venture company in which Sunrise owns a 25% interest. Sunrise realized $3 million in gain, subject to certain contingencies being met, of which $2 million and $1 million was recognized in 2002 and 2001, respectively. Sunrise continues to operate the properties under long-term operating agreements.

In December 2001, Sunrise completed the sale of one property for an aggregate sales price of $8 million. Sunrise realized $1 million in gain, which was recognized in 2001.

In December 2001, Sunrise completed the sale of one property for an aggregate sales price of $16 million to a real estate venture company in which Sunrise owns a 25% interest. Sunrise realized $2 million in gain, subject to certain contingencies being met, of which, $1 million and $500,000 was recognized in, 2002 and 2001, respectively. In 2002, Sunrise also recognized an additional $2 million in incentive purchase price based on 2002 operating performance. Sunrise continues to operate the properties under long-term operating agreements.

In December 2001, one of Sunrise's joint venture partners exercised an option to acquire an additional 25% interest in one property (Sunrise of Gardner Park). As a result of the transaction, Sunrise's ownership in the property was reduced to 25%

from 50%. Sunrise will continue to operate the property under a long-term management agreement. Sunrise realized up to $1 million in gain, subject to certain contingencies being met, of which, $700,000 and $200,000 was recognized in, 2002 and 2001, respectively.

In March 2002, Sunrise completed the sale/long-term manage back of 12 assisted living properties to a real estate investment entity in which Sunrise owns a 20% interest. Sunrise realized $43 million in gain, subject to certain operating contingencies being met, of which $43 million was recognized during 2002. Sunrise will continue to operate the properties under long-term management agreements.

In June 2002, Sunrise completed the sale/long-term manage back of two assisted living properties to a real estate joint venture in which Sunrise owns a 20% interest. Sunrise will realize up to $9 million in gain, subject to meeting certain operating contingencies, of which $2 and $7 million was recognized in 2003 and 2002, respectively. Sunrise will continue to operate the properties under long-term management agreements.

In August 2002, Sunrise completed the sale/long-term manage back of one assisted living property to a real estate joint venture in which Sunrise owns a 20% interest. Sunrise will realize up to $6 million in gain, subject to meeting certain operating contingencies, of which $3 and $3 million was recognized in 2003 and 2002, respectively. Sunrise will continue to operate the property under a long-term management agreement.

In September 2002, Sunrise completed the sale/long-term manage back of two assisted living properties to a real estate joint venture in which Sunrise owns a 20% interest. Sunrise will realize up to $8 million in gain, subject to meeting certain operating contingencies, of which $4 and $4 million was recognized in 2003 and 2002, respectively. Sunrise will continue to operate the properties under a long-term management agreement.

In December 2002, Sunrise completed the sale/long-term manage back of 11 assisted living properties to a real estate joint venture in which Sunrise owns a 20% interest. Sunrise will realize up to $36 million in gain, subject to meeting certain operating contingencies, of which $27 and $9 million was recognized in 2003 and 2002, respectively. Sunrise will continue to operate the properties under a long-term management agreement.

In March 2003, Sunrise completed the sale/long-term manage back of its 100% interest in 10 assisted living properties to a not-for-profit family foundation for an aggregate sales price of $19 million. As part of the sale, Sunrise provided $5 million of seller financing. Sunrise will realize up to $10 million in gain subject to certain contingencies being met, of which $5 million was recognized in 2003. During 2003, Sunrise started to recognize portions of the remaining $5 million gain contingent on the repayment of the seller financing. Sunrise continues to operate the properties under long-term management agreements.

In June 2003, Sunrise completed the sale of 12 consolidated senior living properties and 11 Sunrise joint venture senior living properties. The properties were sold in two separate transactions to two ventures of which Sunrise has a ten percent interest. The aggregate purchase price for the 12 consolidated senior living properties was $167 million and $144 million for the 11 Sunrise joint venture senior living properties. Sunrise realized a $30 million gain from the sale of the 12 consolidated senior living properties, which is being recognized over five quarters beginning in the second quarter of 2003, subject to meeting certain operating and financing contingencies. $21 million of gain was recognized in 2003. The sale of the 11 Sunrise joint venture properties from the original joint venture investor to the new joint venture investor did not result in any income statement impact to Sunrise, however, it did provide for the repayment to Sunrise of all outstanding notes receivable and advances from the existing joint ventures, which approximated $46 million. Sunrise will continue to operate all 23 properties under long-term management contracts.

In September, 2003, Sunrise completed the sale/long-term manage back of five consolidated senior living properties to a venture in which Sunrise owns a 10 percent interest. The aggregate purchase price was $94 million. Sunrise will realize up to $15 million in gain over three quarters beginning in the third quarter of 2003, subject to meeting certain operating contingencies. $9 million of gain was recognized in 2003. Sunrise will continue to operate all five properties under long-term management contracts.

In September 30, 2003, Sunrise completed the sale/long-term manage back of its 100 percent interest in 16 consolidated senior living properties to a retirement properties company for an aggregate sales price of $158 million. Sunrise will realize up to $13 million, subject to meeting certain operating contingencies. $5 million of gain was recognized in 2003. Sunrise will continue to operate all 16 properties under long-term management contracts.

15. Non-Recurring Items

In August 2001, Karrington Health Inc. (Karrington), a wholly owned subsidiary of Sunrise, received a cash payment in the amount of $10 million to settle a lawsuit filed by Karrington prior to its acquisition by Sunrise in 1999. Karrington brought the suit alleging that Omega Healthcare Investors, Inc. had breached a financing commitment it had made to Karrington. Expenses incurred to settle the lawsuit have been netted against the settlement.

Given the current industry environment and the increasing number of opportunities to acquire properties and management contracts, Sunrise determined, in the third quarter of 2001, that the costs to develop five specific sites outweighed the costs of acquiring properties and/or management contracts in those areas. Accordingly, management elected not to proceed with its planned development for these five sites and wrote down associated project costs by $7 million to their estimated net realizable value.

16. Commitments

Sunrise leases its corporate offices, regional offices, development offices and warehouse space under various leases. During 1998, Sunrise entered into an agreement to lease new office space for its corporate headquarters. The lease commenced in July 1999 and expires in July 2013. The lease has an initial annual base rent of $1 million. In September 2003, Sunrise entered an agreement to lease additional office space for its corporate headquarters. The new lease commenced in September 2003 and expires in September 2013. The lease has an initial annual base rent of $3 million. The base rent for both of these leases escalates approximately 2.5% per year in accordance with a base rent schedule. The warehouse lease has a term of seven years and expires in May 2004. The initial annual base rent payments amount to $148,000, subject to annual increases of 3%. In addition, Sunrise is required to amortize an additional $88,000 of rent related to the straight lining of rent benefits and a portion of operating expenses. Various other leases expire between 2003 and 2004.

Sunrise has also entered into operating leases for four properties. Two properties commenced operations during 1997 and two properties commenced operations in 1998. In May 1999 in connection with the acquisition of Karrington, Sunrise assumed six operating leases for six senior living properties and a ground lease. The operating lease terms vary from 15-20 years, with two ten-year extension options. Sunrise also has two other ground leases related to two properties in operation. Lease terms range from 30 to 99 years and are subject to annual increases based on the consumer price index and/or stated increases in the lease.

In March 2003, in connection with the acquisition of Marriott Senior Living Services, Inc. (MSLS), Sunrise assumed 16 operating leases for 17 senior living properties. In June 2003, Sunrise renewed an existing operating lease agreement for another MSLS property. The operating lease terms for these 18 former MSLS properties expire in 2018.

Future minimum lease payments under office, equipment, ground and other operating leases as of December 31, 2003 are as follows (in thousands):

2004	$ 53,698
2005	52,948
2006	53,032
2007	53,117
2008	53,197
Thereafter	340,902
	$606,894

Sunrise has entered into contracts to purchase and lease additional sites. Total contracted purchase price of these sites is $49 million. Sunrise is pursing additional development opportunities and also plans to acquire additional properties as market conditions warrant.

As a part of Sunrise's operating strategy, Sunrise may provide limited debt guarantees to certain of its business ventures. Unless otherwise stated, Sunrise would be required to perform under a debt guarantee if the business venture failed to perform under the debt agreement and the bank pursued the Sunrise guarantee. At December 31, 2003, Sunrise has provided $106 million of debt guarantees to its business ventures which represents Sunrise's maximum exposure under its debt guarantees. Of the $106 million, $2 million of guarantees are for our sale long-term manage back partnerships. These guarantees are removed upon reaching certain occupancy and debt service coverage targets within the partnership. Of the $106 million, $4 million represents a debt guarantee to a joint venture which was acquired in June 2002. This debt guarantee remains in place throughout the term of the loan. Sunrise has provided $9 million of debt guarantees to hospital partnerships that remain in place throughout the term of the loan. In connection with the acquisition of MSLS in March 2003, CNL Retirement Properties, Inc. ("CNL") agreed to assume the obligation to repay $83 million of life care endowment obligations issued by MSLS with respect to two continuing care retirement communities. To the extent that CNL fails to satisfy this obligation, Sunrise would be required to repay this obligation, the majority of which is expected to be refinanced with proceeds from the issuance of new endowment obligations as new residents enter the communities. An additional $8 million related to the acquisition of MSLS is made up of $2 million of obligations to provide financing under existing credit facilities with respect to four communities, $5 million of obligations to provide credit financing for 22 communities and $1 million of payment guarantees under operating agreements with respect to one community. Finally, Sunrise has provided $33 million of debt guarantees to its development joint ventures. Of the $33 million, $19 million are last dollar debt guarantees on international development. Last dollar debt guarantee means the third-party debt would have to default, the bank would have to enforce any remedies against the venture, including foreclosure, after which Sunrise would have to provide any required funds to make up any difference between the loan amount and the amount recovered from such enforcement. Of the $33 million in debt guarantees to development joint ventures, $7 million are removed upon stabilization of the underlying properties. The remaining $26 million will remain in place throughout the term of the loan. To date Sunrise has not been required to fund any debt guarantees. At December 31, 2003, Sunrise does not believe that it will be required to fund any debt under its current outstanding debt guarantees and therefore no liabilities are reflected in the financial statements of Sunrise for these debt guarantees.

As part of Sunrise's fee-development for joint ventures, it typically guarantees that properties will be completed at budgeted costs approved by all partners in the joint venture. Budgeted costs typically include significant contingency reserves for unforeseen costs and potential overruns. Sunrise would be required to fund these guarantees if the actual costs of development exceeded the approved budgeted costs. At December 31, 2003, 14 properties are under construction and subject to completion guarantees. Sunrise has over 20 years experience in the development and construction of senior living properties. Its construction contractors are experienced in building its prototype and assume much of the risk of on-time and on-budget completion by executing fixed-price contracts. Typically, the terms of these guarantees provide for no limitation to the maximum potential future payments under the guarantee. In certain agreements, if amounts are required to be funded by Sunrise, they would become loans to the venture and earn interest. Sunrise closely monitors these projects and does not expect to fund any amounts under these development completion guarantees during 2004. None were funded during 2003.

As a part of certain management contracts, Sunrise may provide an operating deficit credit facility. This means that if a property has depleted all of its operating reserves and does not generate enough cash flow during a month to cover its expenses, Sunrise would provide a loan to the property to cover the cash shortfall. These loans are generally included with Sunrise's development joint ventures and usually are provided for a limited period of time, generally until the property reaches stabilization. Typically, the terms of these loans provide for no limitation to the maximum potential future payments under the loans. As of December 31, 2003, 19 operating properties are subject to a Sunrise operating deficit credit facility and 14 additional properties will be subject to a guarantee upon opening. Sunrise funded $0.4 million under these credit facilities in 2003 related to four properties and does not expects to fund any additional amounts under these guarantees.

17. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes.

The primary components of Sunrise's net deferred tax asset are as follows (in thousands):

	December 31,	
	2003	2002
Deferred tax assets:		
Operating loss carryforward and credits	**$ 17,397**	$ 11,108
Accrued expenses	**4,038**	3,343
Other	**2,135**	1,422
Total deferred tax assets	**$ 23,570**	$ 15,873
Deferred tax liabilities:		
Investments in joint ventures	**$ (53,800)**	$(23,106)
Property and equipment	**(70,254)**	(62,511)
Operating expenditures	**(5,607)**	(10,495)
Total deferred tax liabilities	**(129,661)**	(96,112)
Net deferred tax liability	**$(106,091)**	$(80,239)

At December 31, 2003, Sunrise had regular U.S. federal and state net operating loss carryforwards available to offset future taxable income of approximately $39 million, which expire from 2010 through 2022. At December 31, 2003, Sunrise had alternative minimum tax credits of approximately $0.5 million and Work-Opportunity tax credits of approximately $2 million available to offset future federal tax liabilities. These tax credits do not expire. Various Sunrise entities have fully utilized their net operating loss carryforwards for state tax purposes.

Realization of the net deferred tax asset is dependent on generating sufficient taxable income prior to expiration of the loss carryforwards. Sunrise expects to fully utilize the loss carryforward prior to expiration.

Significant components of the provision for income taxes are as follows (in thousands):

	Year Ended December 31,		
	2003	2002	2001
Current:			
Federal	**$ 7,447**	$ 2,495	$ 2,778
State	**2,564**	2,448	2,389
Total current	**10,011**	4,943	5,167
Deferred:			
Federal	**21,782**	25,727	23,805
State	**3,182**	2,832	2,421
Total deferred	**24,964**	28,559	26,226
Total tax expense	**$34,975**	$33,502	$31,393

In 2003, 2002 and 2001, Sunrise paid federal and state income taxes, net of refunds of $1 million, $2 million and $1 million, respectively. Current taxes payable for 2003, 2002 and 2001 have been reduced by approximately $9 million, $3 million, and $3 million respectively, reflecting the tax benefit to Sunrise of employee stock options exercised during the year. The tax benefit has been recognized as an increase to additional paid-in capital.

The differences between the tax provision calculated at the statutory federal income tax rate and the actual tax provision recorded for each year are as follows:

	Year Ended December 31,		
	2003	2002	2001
Statutory rate	**35%**	35%	35%
State taxes, net	**4**	5	6
Other	**(3)**	(2)	(2)
	36%	38%	39%

18. Related-Party Transactions

Sunrise Assisted Living Foundation

Sunrise Assisted Living Foundation, Inc. ("SALF"), a not-for-profit organization, operates two schools, including day care centers. Paul and Teresa Klaassen, Sunrise's founders, are on the Board of Directors of SALF. SALF reimbursed Sunrise monthly for use of office facilities and support services in the amount of $84,000 in 2003, 2002 and 2001. Such amounts are included in operating revenue. Sunrise had also accepted a promissory note from SALF during 2001 (see Note 4). The principal amount of the promissory note and accrued interest were repaid during 2003.

During 1999, a subsidiary of SALF provided certain health care services to residents of Sunrise properties located in Illinois. The SALF subsidiary entered into various administrative, accounting and collection service agreements with Sunrise that terminated at the end of 2001. The service agreements allow for reimbursement of costs of service plus a management fee. Sunrise recognized management fees of $400,000 in 2001. As of December 31, 2003, Sunrise owed SALF $0.4 million under such service agreements.

Ground Lease

Sunrise has a 99 year ground lease with one of Sunrise's founders. The ground lease expires in May 2085. The basic monthly rent is adjusted annually based on the consumer price index. Rent expense under this lease was $310,000, $299,000 and $296,000 for the years ended December 31, 2003, 2002 and 2001, respectively. Sunrise subleases one-half of this ground lease to SALF. The sublease expires in May 2085 and requires payments equal to 50% of all payments made by Sunrise under the ground lease. Sublease rental income was $155,000, $149,500 and $148,000 for the years ended December 31, 2003, 2002 and 2001, respectively. Lease expense is recorded net of the sublease income.

Joint Ventures

Sunrise has entered into unconsolidated joint venture arrangements with a third party that is providing up to $59 million of the equity capital to develop up to 20 projects in the United States, United Kingdom and Canada. A director of Sunrise, Craig Callen, is a managing director of Credit Suisse First Boston (CSFB) LLC. The parent of CSFB LLC controls through funds sponsored by an affiliate or subsidiary investments, which from time to time have included investments in the joint ventures. Sunrise is providing management and pre-opening services to the joint ventures on a contract-fee basis and has agreed to invest up to $7 million of equity capital in the joint ventures. Sunrise recognized management and contract services fees from these joint ventures of $6 million, $8 million and $9 million, respectively, in 2003, 2002 and 2001. As of December 31, 2003, 2002 and 2001, the third party had provided approximately $51 million, $52 million and $51 million, respectively, and Sunrise has provided $7 million, $6 million and $8 million, respectively, of equity capital to the joint ventures. For information on committed and funded loans to this third party, see Note 4.

Sunrise may allow minority equity ownership interests in joint ventures for its officers as a means of incentive. Currently, two of its corporate officers, Christian Slavin and Tiffany Tomasso, have minority ownership interests (less than 1% combined on a fully diluted basis) in one of its international joint ventures.

19. Profit-Sharing Plan

Sunrise has a profit-sharing plan (the "Plan") under Internal Revenue Code Section 401(k). All employees of Sunrise are covered by the Plan and are eligible to participate in the Plan after meeting certain eligibility requirements. Deferred salary contributions are made through pre-tax salary deferrals of between 1% and 100%.

Effective January 1, 2001, employees vest in their matching employer contributions 100% over four years at 25% each year. When an employee reaches 5 years of service, Sunrise will contribute $0.50 for every dollar the employee contributes up to 7% of the employee's annual compensation. If the employee has less than 5 years of service, the employer contribution will be $0.25 for every dollar the employee contributes up to 7% of the employee's annual compensation. The Plan has eliminated the discretionary matching contributions and all employees who earn $90,000 or less annually are eligible to receive regular matching contributions by Sunrise provided the employee meets certain eligibility requirements. Matching contributions made by Sunrise totaled $800,000, $200,000, and $500,000 during 2003, 2002 and 2001, respectively.

20. Fair Value of Financial Instruments

The following disclosures of estimated fair value were determined by management, using available market information and valuation methodologies. Considerable judgment is necessary to interpret market data and develop estimated fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts Sunrise could realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies may have an effect on the estimated fair value amounts.

Cash equivalents, accounts receivable, accounts payable and accrued expenses, marketable securities, investments and other current assets and liabilities are carried at amounts which reasonably approximate their fair values.

Fixed rate debt with an aggregate carrying value of $181 million has an estimated aggregate fair value of $210 million at December 31, 2003. Estimated fair value of fixed rate debt is based on interest rates currently available to Sunrise for issuance of debt with similar terms and remaining maturities. The estimated fair value of Sunrise's variable rate debt is estimated to be approximately equal to its carrying value of $42 million at December 31, 2003.

Disclosure about fair value of financial instruments is based on pertinent information available to management as of December 31, 2003. Although management is not aware of any factors that would significantly affect the reasonable fair value amounts, these amounts have not been comprehensively revalued for purposes of these financial statements since December 31, 2003 and current estimates of fair value may differ from the amounts presented herein.

21. Information about Sunrise's Segments

With the completion of the MSLS acquisition (see Note 13) and the transformation into a management services organization, Sunrise operates within one defined business segment with activities related to management, development, and acquisition of senior living services both domestically and internationally. Management and contract services revenues from operations internationally were $4 million for the years ended December 31, 2003 and 2002. International expenses from operations were $7 million and $4 million for the years ended December 31, 2003 and 2002, respectively.

22. Quarterly Results of Operations (Unaudited)

The following is a summary of quarterly results of operations for the fiscal quarters: (in thousands, except per share amounts):

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2003				
Operating revenue	**$136,715**	**$334,511**	**$353,311**	**$363,764**
Net income	**13,416**	**16,205**	**17,133**	**15,424**
Diluted net income per common share	**$ 0.56**	**$ 0.67**	**$ .74**	**$ .67**
2002				
Operating revenue	$111,117	$119,888	$130,057	$144,850
Net income	7,472[1]	11,463	15,400	20,326
Diluted net income per common share	$ 0.32	$ 0.47	$ 0.63	$ 0.82

The sum of diluted net income per common share for the four quarters in 2003 and 2002 may not equal diluted net income per common share for the year due to the changes in the number of weighted average shares outstanding and fluctuations in the market price of Sunrise's common stock during the year.

(1) Includes interest expense of approximately $4 million ($2 million net of tax) for fees associated with the $92 million term loan and the premium paid for the early redemption of the convertible notes.

REPORT OF INDEPENDENT AUDITORS

Stockholders and Board of Directors
Sunrise Senior Living, Inc.

We have audited the accompanying consolidated balance sheets of Sunrise Senior Living, Inc. as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2003. 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sunrise Senior Living, Inc. as of December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the Consolidated Financial Statements, in 2002 the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

Ernst + Young LLP

McLean, Virginia
February 26, 2004