FIVE STAR QUALITY CARE INC
Form S-1
October 26, 2004

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As filed with the Securities and Exchange Commission on October 26, 2004

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-1

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

FIVE STAR QUALITY CARE, INC.

(Exact name of registrant as specified in its charter)

Maryland	**8051**	**04-3516029**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

400 Centre Street
Newton, Massachusetts 02458
(617) 796-8387

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Evrett W. Benton, President
Five Star Quality Care, Inc.
400 Centre Street
Newton, Massachusetts 02458
(617) 796-8387

(Name, address, including zip code, telephone number, including area code, of agent for service)

Copy to:

William J. Curry, Esq.
Sullivan & Worcester LLP
One Post Office Square
Boston, Massachusetts 02109
(617) 338-2800

Approximate date of commencement of proposed sale to the public: As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. o

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Unit	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee(2)
Common Stock, $.01 par value per share	2,300,000(1)	$7.10	$16,330,000	$2,069.02

(1) Includes 300,000 shares of common stock which may be purchased by the underwriters to cover over-allotments, if any.

(2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act of 1933, as amended, on the basis of the average high and low prices of the Registrant's common stock on October 21, 2004, as reported by the American Stock Exchange.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any state in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of such state.

PRELIMINARY PROSPECTUS **Subject to completion** **October 26, 2004**

2,000,000 Shares

Common Stock

We are selling all of the 2,000,000 shares of common stock offered in this prospectus.

Our common shares are traded on the American Stock Exchange, under the symbol "FVE". On , the last reported sale price of our common shares on the American Stock Exchange was $ per share.

Investment in our shares involves a high degree of risk. You should read carefully this entire prospectus, including the section entitled "Risk factors" that begins on page 7 of this prospectus, which describes the material risks.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful and complete. Any representation to the contrary is a criminal offense.

	Per share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us	$	$

The underwriters may also purchase from us up to an additional 300,000 shares, at the public offering price less the underwriting discount, to cover over-allotments, if any, within 30 days from the date of this prospectus.

The underwriters are offering our shares as described in "Underwriting". Delivery of the shares will be made on or about .

You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information contained in this prospectus is accurate as of the date on the cover. Changes may occur after that date and we may not update this information except as required by applicable law.

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References in this prospectus to "we", "us", "our", the "Company" or "Five Star" mean Five Star Quality Care, Inc. and its subsidiaries.

Prospectus summary

The following summary highlights information contained in other parts of this prospectus. Because it is a summary, it does not contain all of the information you should consider before investing in our common shares. You should read the entire prospectus carefully, including "Risk factors" and the financial statements and related notes, before making an investment decision.

OUR COMPANY

We operate senior living communities, including independent and assisted living communities and nursing homes. Since we became a separate public company, we have selectively divested nursing homes and acquired independent and assisted living communities where a large majority of the revenues are paid by residents from their private resources. The following charts illustrate the changes in our business since we became a public company on December 31, 2001 to September 30, 2004, adjusted for the pending acquisition of LTA Holdings, Inc., or LTA, described below in "Recent Developments":

Five Star Operations

At December 31, 2001	**At September 30, 2004**
54 nursing homes (5,074 living units) 2 independent living communities (137 living units)	52 nursing homes (4,847 living units) 34 independent living communities (7,821 living units) 62 assisted living communities (3,935 living units)
$229.6 million revenues(1)	**$694.0 million revenues(2)**

(1) Revenues at these communities for the year ended December 31, 2001.

(2) Revenues at these communities for the three months ended September 30, 2004, annualized.

RECENT DEVELOPMENTS

Since January 1, 2004, the following recent developments have occurred:

Improved profits. We earned $0.06/share, $0.11/share and $0.   /share in the three month periods ended March 31, June 30 and September 30, 2004, respectively. Since we became a separate public company until 2004, we were not consistently profitable. We believe that our recently improved financial performance is the result of changes in our business which we have implemented; but, of course, our future profitability is not guaranteed. See "Risk factors" beginning on page 6.

LTA acquisition. In September 2004, we agreed to acquire LTA for approximately $208 million. LTA owns and operates 47 senior living communities with 2,636 living units, which primarily offer assisted living services. LTA's historical revenues from these communities for the six months ended June 30, 2004 annualized was $78.9 million, and 100% of these revenues were paid by residents from their private resources. LTA also manages 12 assisted living communities for third party owners, but we do not know if we will continue to manage these communities. We intend to finance the LTA acquisition with cash on hand, assumption of certain mortgage debt and leasehold obligations, and a sale leaseback of 35 LTA communities for $165 million. Our business plan for the LTA communities is to increase revenues by increasing occupancies at the communities. We also expect to realize cost savings by combining the LTA operations with our existing operations. We can provide no assurances that the expected financial benefits from the LTA acquisition will be achieved. Completion of the LTA acquisition is subject to various conditions customary in transactions of this type, including licensing and receiving third party consents. We expect this transaction to close before year end 2004, but there is no assurance that it will close. This offering is not contingent upon the closing of the LTA acquisition.

Pharmacy expansion. In September 2004, we purchased an institutional pharmacy business located in Lincoln, Nebraska for $3 million. This business currently provides pharmacy services to 24 nursing homes. Our business plan is to expand this business by offering pharmacy services at some or all of the 14 communities which we operate in Nebraska. We used cash on hand to complete this acquisition.

OUR GROWTH STRATEGY

In addition to managing our existing operations, we intend to continue to grow our business.

Our principal growth strategy is to acquire independent and assisted living communities where a large majority of the revenues are paid with residents' private resources. We prefer to purchase communities which have achieved or are close to stabilized operations. For example, the LTA communities which we expect to acquire have current occupancy of approximately 85%, while the independent and assisted living communities we now operate have current occupancy of approximately 90%. We also try to make acquisitions where we can realize cost savings by combining operations with our existing operations.

Starting in the mid 1990s, a large number of independent and assisted living communities were developed with financing from private equity and real estate opportunity funds. We believe that many of these communities are now at or approaching stabilized operations and many of these financial investors are now anxious to sell. For example: in 2002, we acquired 15 independent and assisted living communities which were assembled and developed by Constellation Health Services, Inc., a division of Constellation Energy Group, Inc., f/k/a Baltimore Gas and Electric Company; and the controlling shareholder of LTA is a private equity fund that was created by an investment bank. We expect to pursue similar acquisitions for the next several years.

We also intend to expand our institutional pharmacy business. We acquired our first pharmacy in Waukesha, Wisconsin in 2003. As described in "Business Recent Developments", during 2004, we acquired a second pharmacy located in Lincoln, Nebraska. Whenever we buy an institutional pharmacy business we seek to grow its business by providing pharmacy services at our senior living communities within the same service area. We are currently interested in acquiring pharmacies in other areas where we own senior living communities. We can provide no assurances that we will be able to continue these pharmacy expansion activities, but we intend to do so.

Although expansion of our nursing home business is not our primary growth strategy, we have in the past considered acquiring more nursing homes. Most nursing homes are financially dependent upon the Medicare and Medicaid programs. Accordingly, we believe the potential for profitable operations of nursing homes is limited by government rate setting. In these circumstances, we are only interested in expanding our nursing home operations at prices which we believe take account of the risks inherent in government rate setting. In the past few years, we have not been able to buy nursing homes at prices we consider appropriate, but we may continue to investigate such opportunities in the future.

HISTORICAL AND CURRENT RELATIONS WITH SENIOR HOUSING PROPERTIES TRUST AND SUNRISE SENIOR LIVING, INC.

We were formed in 2000 as a subsidiary of Senior Housing Properties Trust, or Senior Housing, a publicly owned real estate investment trust, or REIT. We were created to operate nursing homes owned by Senior Housing which were repossessed from defaulting tenants. During 2000 and 2001, we closed certain unprofitable nursing homes and we stabilized operations at others. On December 31, 2001, we began to lease the nursing homes from Senior Housing which we formerly operated for it, and substantially all of our shares were distributed to Senior Housing shareholders. Although we are now a separate public company, we maintain close relations with Senior Housing. Two of our directors are also trustees of Senior Housing. Senior Housing and we sometimes consider joint acquisition opportunities. Ninety-seven of the total 101 senior living communities which we currently operate are owned by, and leased from, Senior Housing, and Senior Housing has agreed to a sale and leaseback transaction which will provide the majority of our funding for the LTA acquisition. We believe our close relationship with Senior Housing benefits us because it affords us an ability to consider larger investments than our independent resources might permit.

At the time of our spin off from Senior Housing, we agreed to lease 31 senior living communities with 7,418 living units which Senior Housing had agreed to purchase. These communities were operated under long term contracts by a subsidiary of Marriott International, Inc., or Marriott. In 2003, Marriott sold its senior living subsidiary to a subsidiary of Sunrise Senior Living, Inc., or Sunrise. At about that time, Marriott and we had litigation concerning whether we could terminate Sunrise's management as a result of this sale, among other matters. This litigation was settled in early 2004, and Sunrise now operates these communities for our account. By mutual agreement of Sunrise and us, one of these communities was closed in May 2004. Our annualized revenues from the remaining 30 Sunrise managed communities is approximately $300 million, and these revenues, rent to Senior Housing and management fees to Sunrise related to these communities are recorded in our income statement. We continue to believe that the loss of the "Marriott" name was a serious loss for marketing these communities, but we are working with Sunrise to maintain and improve these operations.

THE OFFERING

Common stock being offered	2,000,000 shares
Common stock to be outstanding after the offering	10,538,634 shares
Use of proceeds	The net proceeds to us from this offering will be $13.1 million, assuming a public offering price of $7.10 per share. We intend to use these net proceeds for general business purposes, including possible acquisitions which have not yet been identified.
American Stock Exchange symbol	FVE
Risk factors	An investment in our common shares involves significant risks. Before making an investment in our common shares, you should carefully review the information under the caption "Risk factors".

The number of shares to be outstanding after the offering is based on 8,538,634 shares outstanding on October 21, 2004. If the underwriters exercise their over-allotment option in full, we will issue an additional 300,000 shares. Unless otherwise stated, all information contained in this prospectus assumes no exercise of the over-allotment option we granted to the underwriters.

We are a Maryland corporation. Our principal place of business is 400 Centre Street, Newton, Massachusetts 02458, and our telephone number is (617) 796-8387.

SUMMARY HISTORICAL AND PRO FORMA FINANCIAL DATA

The following summary financial data has been derived from the financial statements included elsewhere in this prospectus, and shows, for the period or date presented, our summary historical and pro forma income statement and balance sheet data, giving effect to this offering and our pending acquisition of LTA, including the sale and leaseback to Senior Housing of certain of the acquired communities. As discussed under "Risk factors" and "Management's discussion and analysis of financial condition and results of operations", our historical financial information is not necessarily reflective of our current operations. Accordingly, you should not place undue reliance on our historical financial information. In addition, pro forma financial information may not be reflective of what our financial results or financial position would have been had the LTA acquisition, including the sale leaseback with Senior Housing, been completed as of the dates indicated in our pro forma financial statements.

	For the six months ended June 30, 2004		
	Historical	**After giving pro forma effect to the pending LTA acquisition**	**As adjusted for this offering after giving pro forma effect to the pending LTA acquisition**
	(dollars in thousands, except per share data)		
Statement of Operations Data			
Revenues	$ 305,045	$ 344,540	$ 344,540
Property operating expenses	241,230	268,347	268,347
Management fee to Sunrise	9,191	9,191	9,191
Rent expense	40,582	48,599	48,599
General and administrative	9,935	13,539	13,539
Depreciation and amortization	1,839	2,289	2,289
Interest expense	245	1,399	1,399
Total expenses	303,022	343,364	343,364
Income from continuing operations before gain on sale of assets, equity in income of affiliates and income taxes	2,023	1,176	1,176
Gain on sale of assets		6	6
Equity in income of affiliates		27	27
		33	33
Income from continuing operations before income taxes	2,023	1,209	1,209
Provision for income taxes			
Income from continuing operations	$ 2,023	$ 1,209	$ 1,209
Income per share from continuing operations	$ 0.24	$ 0.14	$ 0.12
Weighted average shares	8,520	8,520	10,520
Other data:			
Occupancy	89%	89%	89%
Total units	13,967	16,603	16,603
Private pay % of revenue	57%	63%	63%
Income from continuing operations	$ 2,023	$ 1,209	$ 1,209
add depreciation and amortization	245	2,289	2,289
add interest expense	1,839	1,399	1,399
EBITDA (1)	$ 4,107	$ 4,897	$ 4,897

Balance Sheet Data						
Cash and cash equivalents	$	28,879	$	30,539	$	43,674
Total current assets		68,394		73,375		86,510
Total assets		145,937		183,699		196,834
Short-term liabilities		51,141		59,256		59,256
Long-term liabilities		28,863		58,510		58,510
Common equity	$	65,933	$	65,933	$	79,068

(1) We consider earnings before interest, taxes, depreciation and amortization, or EBITDA, to be an indicative measure of our operating performance. EBITDA is also useful in measuring our ability to service debt, fund capital expenditures and expand our business. Furthermore, we believe that EBITDA is a meaningful disclosure that will help shareholders and the investment community to understand better our financial performance, including comparing our performance to other companies. However, EBITDA as presented may not be comparable to amounts calculated by other companies. This information should not be considered as an alternative to net income, income from continuing operations, operating profit, cash flow from operations, or any other operating or liquidity performance measure prescribed by accounting principles generally accepted in the United States. Cash expenditures for various long term assets, interest expense and income taxes are not reflected in EBITDA and have been and will be incurred.

Risk factors

Investing in shares of our common stock, or common shares, entails significant risk. The following is a description of the material risks which we can identify. There may be additional risks and uncertainties not presently known to us or that we currently deem immaterial that may also impair our business operations. You should carefully consider the risks and uncertainties described below and elsewhere in this prospectus before making an investment decision.

A small percentage decline in our revenues or increase in our expenses can have a large negative percentage impact upon our operating results.

For the first six months of 2004, our revenues were $305 million and our expenses were $303 million. A small percentage decline in our revenues or increase in our expenses might have a dramatic negative impact upon our income.

Our growth strategy may not succeed.

Our business plan includes acquiring additional senior living communities and institutional pharmacies. This growth strategy involves risks. For example:

- we may be unable to locate senior living communities or pharmacies available for purchase at acceptable prices;
- we may be unable to access the capital to acquire or operate the expanded business;
- acquired operations may bring with them contingent liabilities which mature;
- to the extent we incur acquisition debt or leases, our operating leverage may increase; and
- combining our present operations with newly acquired operations may be disruptive of the operations or cost more than anticipated when acquisition prices are determined.

For these reasons and others:

- our business plan to grow may not succeed;
- the benefits which we hope to achieve by growing may not be achieved; and
- our existing operations may suffer from a lack of management attention or financial resources if such attention and resources are devoted to a failed growth strategy.

Our pending acquisition of LTA may not be completed and, if it is, we may not achieve anticipated benefits.

Our pending purchase of LTA is subject to licensing, receiving third party consents and other conditions. Although we expect to complete this purchase before December 31, 2004, it may not occur by then or ever.

The financial benefits we expect to realize from the LTA acquisition are largely dependent upon our ability to increase the occupancy of the LTA communities and to realize cost savings by combining the LTA operations with our existing operations. If the LTA acquisition does not occur or if our management of the LTA communities does not increase revenues and lower historical costs, we will not realize the presently anticipated benefits and we may experience losses.

Our insurance costs have increased and may continue to increase.

In several well publicized instances, private litigation by residents of senior living communities for alleged abuses have resulted in large damage awards against other operating companies. Today, some lawyers and law firms specialize in bringing litigation against senior living companies. As a result of this litigation and potential litigation, our cost of liability insurance has increased dramatically during the past few years. Workers compensation and employee health insurance costs have also increased in recent years. To partially offset these increases we have increased the amounts of our self insurance by use of higher deductibles and captive insurance companies. Medical liability insurance reform has become a topic of political debate and some states have enacted legislation to limit future liability awards. However, if such reforms are not generally adopted, we expect our insurance costs may continue to increase. Although our reserves for self insurance have been determined with guidance from third party professionals, our reserves may prove inadequate. Increasing insurance costs and increasing reserves may materially negatively affect our results of operations.

Our business is subject to extensive regulation which increases our costs and may result in losses.

Licensing and Medicare and Medicaid laws require operators of senior living communities to comply with extensive standards governing operations. There are also various laws prohibiting fraud by senior living operators, including criminal laws that prohibit false claims for Medicare and Medicaid and that regulate patient referrals. In recent years, the federal and state governments have devoted increased resources to monitoring quality of care at senior living communities and to anti-fraud investigations. When quality of care deficiencies are identified or improper billing is uncovered, various sanctions may be imposed, including denial of new admissions, exclusion from Medicare or Medicaid program participation, monetary penalties, governmental oversight or loss of licensure. Although our communities receive notices of sanctions from time to time, at October 21, 2004, none of our communities was the subject of a regulatory sanction. However, a result of this extensive regulatory system and increasing enforcement initiatives has been to increase our costs of monitoring quality of care compliance and billing procedures, and we expect these costs may continue to increase. Also, if we become subject to regulatory sanctions, our business may be adversely affected and we might experience financial losses.

The failure of Medicare and Medicaid rates to match our costs will reduce our income.

Some of our operations, especially our nursing homes, receive significant revenues from the Medicare and Medicaid programs. During the nine months ended September 30, 2004, approximately 41% of our total revenues was received from these programs. The federal government and some states are now experiencing fiscal deficits. Historically when governmental deficits have increased, cut backs in Medicare and Medicaid funding have often followed. These cut backs sometimes include rate reductions, but more often result in a failure of Medicare and Medicaid rates to increase in sufficient amounts to pay increasing costs. We cannot now predict whether future Medicare and Medicaid rates will be sufficient to cover our future cost increases; however, we are concerned that current governmental fiscal deficits may result in future rate reductions or a failure of future rates to cover our cost increases. Future Medicare and Medicaid rate declines or a failure of these rates to cover increasing costs would result in our experiencing lower earnings or losses.

Sunrise's management of 30 of our communities may have adverse consequences to us.

In March 2003, Marriott sold its subsidiary which manages 30 communities for us to Sunrise. We believe Sunrise's financial condition and reputation as an operator of senior living communities is weaker than the financial condition and reputation of Marriott. The operations and the financial results which we realize from the communities managed for us by Sunrise have declined as a result of this sale and this decline may continue.

We are subject to possible conflicts of interest.

Our continuing business is subject to possible conflicts of interest, as follows:

Our Chief Executive Officer, Evrett W. Benton, and our Chief Financial Officer, Bruce J. Mackey Jr., are also part-time employees of Reit Management and Research LLC, or RMR. RMR is the investment manager for Senior Housing and we purchase various services from RMR pursuant to a shared services agreement.

Our managing directors, Barry M. Portnoy and Gerard M. Martin, are also managing trustees of Senior Housing. Messrs. Portnoy and Martin also own RMR and another entity that leases office space to us.

We do not believe that these conflicts have caused our business to be adversely affected. However, future business dealings between us and Senior Housing, RMR, Messrs. Portnoy and Martin and their affiliates may be on terms less favorable to us than we could achieve on an arm's length basis.

Our business requires regular capital expenditures.

Physical characteristics of senior living communities are mandated by various governmental authorities. Changes in these regulations may require us to make significant expenditures. In the future, our communities may require significant expenditures to address ongoing required maintenance and to make them attractive to residents. Our available financial resources may be insufficient to fund these expenditures.

Our business is highly competitive and we may be unable to operate profitably.

We compete with numerous other companies that provide senior living services, including home healthcare companies and other real estate based service providers. Historically, nursing homes have been somewhat protected from competition by state laws requiring certificates of need to develop new communities; however, these barriers are being eliminated in many states. Also, there are few barriers to competition for home healthcare or for independent and assisted living services. Growth in the availability of nursing home alternatives, including assisted living communities, has had and may in the future have the effect of reducing the occupancy or profitability at nursing homes, including those we operate. Many of our existing competitors are larger and have greater financial resources than we do. Accordingly, we cannot provide any assurances that we will be able to attract a sufficient number of residents to our communities or that we will be able to attract employees and keep wages and other employee benefits, insurance costs and other operating expenses at levels which will allow us to compete successfully or to operate profitably.

Anti-takeover provisions in our governing documents and in our material agreements may prevent shareholders from receiving a takeover premium for their shares.

Our charter places restrictions on the ability of any person or group to acquire beneficial ownership of more than 9.8% (in number of shares or value, whichever is more restrictive) of any class of our equity shares. Additionally, the terms of our leases with Senior Housing and our shared services agreement with RMR provide that our rights under these agreements may be cancelled by Senior Housing and RMR, respectively, upon the acquisition by any person or group of more than 9.8% of our voting stock, and upon other change in control events, as defined in those documents. If the breach of these ownership limitations causes a lease default, shareholders causing the default may become liable to us or to other shareholders for damages. Additionally, on March 10, 2004, we entered into a rights agreement whereby in the event a person or group of persons acquires or attempts to acquire 10% or more of our outstanding common shares, our shareholders, other than such person or group, will be entitled to purchase additional shares or other securities or property at a discount. These agreements and other provisions in our charter and bylaws may increase the difficulty of acquiring control of us by means of a tender offer, open market purchases, a proxy fight or otherwise, if the acquisition is not approved by our board of directors. Other provisions in our governing documents which may deter takeover proposals include the following:

- staggered terms for members of our board of directors;
- the power of our board of directors, without a shareholders' vote, to authorize and issue additional shares and classes of shares on terms that it determines;
- a 75% shareholder vote and cause requirement for removal of directors; and
- advance notice procedures with respect to nominations of directors and shareholder proposals.

For all of these reasons, shareholders may be unable to cause a change of control of us or to realize a change of control premium for their common shares.

Warning concerning forward looking statements

THIS PROSPECTUS CONTAINS FORWARD LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND FEDERAL SECURITIES LAWS. THESE STATEMENTS REFLECT OUR INTENT, BELIEF OR EXPECTATIONS, OR THE INTENT, BELIEF OR EXPECTATIONS OF OUR DIRECTORS AND OFFICERS, BUT THEY ARE NOT GUARANTEED TO OCCUR. FOR EXAMPLE:

- OUR FUTURE INSURANCE COSTS AND INSURANCE RESERVE CALCULATIONS MAY BE GREATER THAN WE NOW ANTICIPATE;
- WE MAY BE UNABLE TO CARRY OUT OUR BUSINESS PLAN TO EXPAND BECAUSE WE ARE UNABLE TO LOCATE EXPANSION OPPORTUNITIES AT PRICES WE ARE WILLING OR ABLE TO PAY;
- OUR RECEIVABLES RESERVES MAY BE INADEQUATE, ESPECIALLY THE RESERVES WHICH RELATE TO MEDICARE AND MEDICAID PAYMENTS BECAUSE SUCH PAYMENTS ARE SUBJECT TO GOVERNMENTAL AUDITS AND TO GOVERNMENT FISCAL POLICIES;
- OUR PENDING ACQUISITION OF LTA MAY NOT BE CONCLUDED BECAUSE OF OUR FAILURE TO RECEIVE A THIRD PARTY CONSENT OR OTHERWISE;
- WE MAY BE UNABLE TO MAINTAIN OR IMPROVE OUR FUTURE OCCUPANCY RATES AND AS A RESULT OUR REVENUES MAY DECLINE;
- THE IMPROVING ECONOMY MAY RESULT IN WAGE PRESSURES WHICH INCREASE OUR FUTURE COSTS;
- FUTURE MEDICARE AND MEDICAID RATES MAY BE LOWER THAN WE NOW ANTICIPATE;
- SUNRISE'S OPERATIONS OF THE COMMUNITIES WHICH IT MANAGES FOR US MAY RESULT IN LOSSES TO US; OR
- WE MAY BECOME SUBJECT TO FINES OR REGULATORY SANCTIONS WHICH MATERIALLY ADVERSELY AFFECT OUR FINANCIAL CONDITION OR PERFORMANCE.

IN ANY SUCH EVENT, OUR FUTURE FINANCIAL PERFORMANCE MAY CAUSE THE IMPROVEMENTS IMPLIED BY OUR RECENT PERFORMANCE TO REVERSE AND WE MAY EXPERIENCE LOSSES. IF OUR FINANCIAL RESULTS DO NOT CONTINUE TO IMPROVE OUR STOCK PRICE LIKELY WILL DECLINE. AN INVESTMENT IN OUR SECURITIES INVOLVES A HIGH DEGREE OF RISK OF LOSS, AND INVESTORS SHOULD NOT PLACE UNDUE RELIANCE UPON FORWARD LOOKING STATEMENTS WHICH IMPLY OTHERWISE.

Use of proceeds

Our net proceeds from this offering, assuming a public offering price of $7.10, the average of the high and low prices of our common shares on the American Stock Exchange on October 21, 2004, and after deduction of the underwriting discount and estimated offering expenses payable by us, are estimated to be $13.1 million ($15.2 million if the underwriters' over-allotment option is exercised in full). We intend to use these net proceeds for general business purposes, including possible acquisitions which have not been identified. Until we utilize the net proceeds, we may deposit all or a portion of the net proceeds in interest bearing accounts or invest them in short term securities, including securities that may not be investment grade rated.

Market price of common shares

Our common shares are traded on the American Stock Exchange under the symbol "FVE". The following table sets forth for the periods indicated the high and low closing price for our common shares as reported by the American Stock Exchange:

2002	**Low**	**High**
First Quarter	$ 6.97	$ 8.75
Second Quarter	5.35	7.35
Third Quarter	1.07	5.50
Fourth Quarter	0.96	2.09
2003		
First Quarter	$ 1.11	$ 1.75
Second Quarter	1.07	1.75
Third Quarter	1.45	2.46
Fourth Quarter	2.06	4.45
2004		
First Quarter	$ 3.83	$ 6.23
Second Quarter	3.65	5.10
Third Quarter	4.28	7.60

The closing price of our common shares on the American Stock Exchange on October 21, 2004, was $7.13 per share.

As of October 21, 2004, there were 3,890 shareholders of record of our common shares, and we estimate that as of such date there were approximately 60,500 beneficial owners of our common shares.

Dividend policy

We do not expect to pay dividends in the foreseeable future.

Capitalization

The following table describes our capitalization, as of June 30, 2004, on a historical and pro forma basis, giving effect to our pending acquisition of LTA, including the sale and leaseback to Senior Housing of certain of the acquired communities, and as adjusted for this offering assuming a public offering price of $7.10 per share.

	Historical	After giving pro forma effect to the pending LTA acquisition	As adjusted for this offering and after giving pro forma effect to the pending LTA acquisition
		(dollars in thousands)	
Cash	$ 28,879	$ 30,539	$ 43,674
Debt	$ 5,007	$ 36,197	$ 36,197
Shareholders' equity:			
Common stock, par value $0.01 per share; 20,000,000 shares authorized; shares outstanding: 8,538,634 historical; 10,538,634 as adjusted	85	85	105
Additional paid in capital	86,301	86,301	99,416
Accumulated deficit	(20,453)	(20,453)	(20,453)
Total shareholders' equity	$ 65,933	$ 65,933	$ 79,068
Total capitalization	$ 70,940	$ 102,130	$ 115,265

Dilution

The recent trading price of our common shares is less than their book value per share determined according to generally accepted accounting principles, or GAAP. Accordingly, assuming that you purchase our shares at the price set forth on the cover of this prospectus, you will not suffer dilution in book value. Book value per share at June 30, 2004, was $7.72; as adjusted for this offering, assuming a public offering price of $7.10 per share, book value per share will be $7.50.

Selected financial data

The following table presents selected financial data which has been derived from our historical financial statements for the period from April 27, 2000 (the date we commenced operations) through December 31, 2003 and for the six months ended June 30, 2003 and 2004. The following data should be read in conjunction with, and is qualified in its entirety by reference to, our consolidated financial statements and the notes thereto included elsewhere in this prospectus. Prior to December 31, 2001, we were owned by Senior Housing and, as discussed under "Management's discussion and analysis of financial condition and results of operations", our historical financial information before January 1, 2002 is not fully reflective of our current operations. Accordingly, you should not place undue reliance on our historical financial information before January 1, 2002.

	Six months ended June 30,		Year ended December 31,			Period from April 27, 2000 through December 31,
	2004	2003	2003	2002	2001	2000
	(unaudited)					
	(dollars in thousands, except per share amounts)					
Operating data:						
Total revenues	$ 305,045	$ 282,232	$ 576,215	$ 519,403	$ 219,834	$ 2,222
Net income (loss) from continuing operations	2,023	(3,813)	(7,567)	(10,259)	1,473	(1,614)
Net income (loss) from discontinued operations	(574)	(699)	(372)	(2,915)	(946)	298
Net income (loss)	$ 1,449	$ (4,512)	$ (7,939)	$ (13,174)	$ 527	$ (1,316)
Per common share data:						
Income (loss) from continuing operations	$ 0.24	$ (0.45)	$ (0.89)	$ (1.36)	$ 0.34	$ (0.37)
Income (loss) from discontinued operations	(0.07)	(0.08)	(0.05)	(0.38)	(0.22)	0.07
Net income (loss)	$ 0.17	$ (0.53)	$ (0.94)	$ (1.74)	$ 0.12	$ (0.30)
Balance sheet data (as of December 31):						
Total assets	$ 145,937	$ 141,079	$ 147,370	$ 133,197	$ 68,043	$ 54,788
Total indebtedness	5,007	17,380	10,435	16,123		100
Other long term obligations	23,904	13,946	18,417	17,723		
Total shareholders' equity	$ 65,933	$ 66,134	$ 64,427	$ 65,047	$ 50,233	$ 54,688

The following table presents selected financial data from 1999 and 2000 derived from historical financial statements of our two predecessors, Integrated Health Services, Inc. and Mariner Post-Acute Network, Inc., prior to their acquisition by Senior Housing.

	Year ended December 31,	
	2000	1999
	(dollars in thousands)	
Integrated Health Services, Inc.		
Operating data:		
Operating revenues	$ 135,378	$ 130,333
Net loss	(25,252)	(126,939)
Balance sheet data (as of December 31):		
Total assets	$ 34,942	$ 61,274
Long term liabilities		17,500
Mariner Post-Acute Network, Inc.		
Operating data:		

	Year ended December 31,	
Operating revenues	$ 85,325	$ 86,945
Net loss	(7,421)	(43,804)
Balance sheet data (as of December 31):		
Total assets	$ 23,052	$ 17,433
Long term liabilities	32,090	28,603

Management's discussion and analysis of financial condition and results of operations

You should read the following discussion in conjunction with our financial statements included elsewhere in this prospectus.

OVERVIEW

We were formed as a 100% owned subsidiary of Senior Housing. Effective July 1, 2000, we assumed the operations of healthcare communities from two bankrupt former tenants of Senior Housing. Pursuant to tax laws applicable to REITs, Senior Housing engaged FSQ, Inc., an independent operating company formed by our managing directors, to manage these communities. At the time we assumed operations of these communities, we had not received substantially all of the required licenses for these communities. As a result, for the period from July 1, 2000 through December 31, 2000, we accounted for the operations of these communities using the equity method of accounting and we only recorded the net income from these operations. Thereafter, we obtained all necessary licenses to operate these communities, and on January 1, 2001, we began to consolidate the results of operations of these communities. On December 31, 2001, Senior Housing distributed substantially all of our shares to its shareholders in a spin off transaction and we became a separately traded public company. On January 2, 2002, in order to acquire the personnel, systems and assets necessary to operate these communities, we acquired FSQ, Inc. by merger.

Since we succeeded to substantially all of the business formerly conducted by subsidiaries or units of two former tenants of Senior Housing, these subsidiaries and units are considered to be our predecessors. See "Selected financial data" for a discussion of financial data of our predecessors.

Our revenues consist primarily of payments for services provided to residents at our communities. The payments are either made by the residents, their families or insurers, referred to as private pay revenues, or by the Medicare and Medicaid programs. For the year ended December 31, 2003 and the six months ended June 30, 2004, private pay revenues represented 61% and 57% of our total revenues, respectively. Our expenses consist primarily of rent, wages and benefits of personnel, food, supplies, insurance and other resident care costs, as well as taxes, and other property related costs.

OUR HISTORICAL RESULTS OF OPERATIONS

As described above, until completion of the spin off, we operated as a subsidiary of Senior Housing. Our past operations as Senior Housing's subsidiary prior to 2002 differ from our 2002, 2003 and current operations as an independent public company. Specifically, in 2000 and 2001, we operated only 56 communities for Senior Housing, which owned the real estate as well as the operations. Effective December 31, 2001, we began to lease these 56 communities (now 53 communities as we have closed and sold three communities) from Senior Housing which continued to own the real estate. In January 2002, we leased from Senior Housing an additional 31 communities (now 30 communities as we have closed one community) that are currently managed by Sunrise. Since Sunrise assumed this management from Marriott, the financial results of these communities have declined and this decline has had a material and adverse impact on our financial results. We are having discussions with Sunrise concerning possible improvements in the financial results of these operations. In April 2002, October 2002 and May 2003, we acquired and began to operate five, 15 and three, respectively, additional senior living communities. During 2002 and 2003, we disposed of six senior living communities. Our principal source of financing as a subsidiary of Senior Housing prior to 2002 was intercompany advances from Senior Housing, an entity with financial resources substantially in excess of ours. Because of these differences, we believe that our historical results of operations for periods prior to 2002 described below are not comparable to our operations since then or our expected future operations.

RESULTS OF OPERATIONS

Key Statistical Data (for the three and six months ended June 30, 2004 and 2003)

The following tables present an overview of our portfolio for the three and six months ended June 30, 2004 and 2003:

	Three Months ended June 30			Six months ended June 30		
	2004	2003	Change	2004	2003	Change
Revenues from residents (in 000s)	$ 150,497	$ 140,448	7%	$ 298,362	$ 282,004	6%
Community expenses (in 000s)	$ 121,695	$ 113,500	7%	$ 241,230	$ 228,830	5%
Total expenses (in 000s)	$ 152,487	$ 141,987	7%	$ 303,022	$ 286,045	6%
No. of communities (end of period)	101	100	1	101	100	1
No. of living units (end of period)	13,967	13,862	105	13,967	13,862	105
Occupancy	89%	89%		89%	89%	
Average daily rate	$ 132	$ 124	6%	$ 132	$ 126	5%
Revenue per day per available unit	$ 117	$ 110	6%	$ 117	$ 112	5%
Percent of revenues from Medicare / Medicaid	43%	42%	1%	43%	43%	
Percent of revenues from private / other	57%	58%	-1%	57%	57%	

"Same Store" Communities (communities that we operated continuously since April 1, 2003 and January 1, 2003, respectively):

	Three Months ended June 30			Six months ended June 30		
	2004	2003	Change	2004	2003	Change
Revenues from residents (in 000s)	$ 148,730	$ 140,125	6%	$ 295,576	$ 281,682	5%
Community expenses (in 000s)	$ 118,184	$ 113,248	4%	$ 234,992	$ 228,578	3%
No. of communities (end of period)	97	97		97	97	
No. of living units (end of period)	13,719	13,719		13,719	13,719	
Occupancy	89%	89%		89%	90%	-1%
Average daily rate	$ 132	$ 125	6%	$ 133	$ 127	5%
Revenue per day per available unit	$ 118	$ 111	6%	$ 118	$ 113	4%
Percent of revenues from Medicare / Medicaid	43%	42%	1%	43%	43%	
Percent of revenues from private / other	57%	58%	-1%	57%	57%	

Three Months Ended June 30, 2004, Compared to Three Months Ended June 30, 2003

Total revenues from residents for the three months ended June 30, 2004 were $150.5 million, an increase of 7% over revenues from residents of $140.5 million for the three months ended June 30, 2003. This increase is due primarily to higher per diem charges to residents and revenues from three additional communities that we began to operate on May 30, 2003. Revenues from residents at the communities that we have operated continuously since April 1, 2003, were $148.7 million and $140.1 million, for the three months ended June 30, 2004 and 2003, respectively, an increase of 6%. This increase is due primarily to higher per diem charges to residents. Approximately 43% and 42% of our revenues from residents in the three months ended June 30, 2004 and 2003, respectively, were received from Medicare and Medicaid. Revenues from our pharmacy, which was acquired in September 2003, were $2.9 million for the three months ended June 30, 2004.

Interest and other income increased by $94,000 in the three months ended June 30, 2004 to $206,000, compared to $112,000 in the three months ended June 30, 2003, primarily due to interest earned on mortgage notes receivable. The notes were received in the second half of 2003 as a result of asset sales.

Expenses for the three months ended June 30, 2004 were $152.5 million, an increase of 7% over expenses of $142.0 million for the three months ended June 30, 2003. Our wages and benefits costs increased from $78.0 million to $79.9 million, or 2%, primarily due to wage increases as well as wages related to three communities we began to operate on May 30, 2003 and the pharmacy we acquired in September 2003. Other operating expenses, which include utilities, housekeeping, dietary, maintenance, insurance and community level administrative costs, increased from $35.5 million to $41.8 million, or 18%, primarily as a result of our operation of three additional properties on May 30, 2003 and our pharmacy acquisition in September 2003 as well as increased charges from third parties. Management fees related to the 30 communities managed for us by Sunrise for the three months ended June 30, 2004 and 2003, were $4.6 million and $4.2 million, respectively. The increase in fees at these 30 communities is the result of increased revenues at these communities. Rent expense to Senior Housing increased from $19.0 million to $20.5 million, or 8%, primarily due to the addition of three communities we began to lease in May 2003, and additional rent for capital improvements that were funded by Senior Housing in 2003 and 2004. Community level operating expenses related to the communities we operated throughout the three months ended June 30, 2004 and June 30, 2003 were $118.2 million and $113.2 million, respectively, an increase of 4%. This increase is primarily due to wage increases as well as increased charges from third parties.

Our general and administrative expenses for the three months ended June 30, 2004 were $4.8 million, an increase of 19% over expenses of $4.0 million for the three months ended June 30, 2003, primarily due to costs resulting from our increased operations and wage increases for our corporate personnel.

Depreciation expense for the three months ended June 30, 2004 was $865,000, a decrease of 6% over depreciation expense of $920,000 for the three months ended June 30, 2003. This change is the net effect of decreases attributable to our sale of three communities in the second half of 2003, offset by increases attributable to our purchase of furniture and fixtures related to the 30 communities that Sunrise manages.

Loss from discontinued operations for the three months ended June 30, 2004 was $124,000, a decrease of $526,000 over the loss for the three months ended June 30, 2003. This decrease is primarily the result of our ceasing operations at seven properties in the 2003 period compared with one property in the 2004 period.

As a result of the factors described above, our net income for the three months ended June 30, 2004 was $943,000 compared to a loss of $2.1 million for the three months ended June 30, 2003. Our net income per share for the three months ended June 30, 2004 was $0.11 compared to a loss per share of $0.25 for the three months ended June 30, 2003.

Six Months Ended June 30, 2004, Compared to Six Months Ended June 30, 2003

Total revenues from residents for the six months ended June 30, 2004 were $298.4 million, an increase of 6% over revenues from residents of $282.0 million for the six months ended June 30, 2003. This increase is due primarily to higher per diem charges to residents and our beginning operations at three additional communities on May 30, 2003. Revenues from residents at the communities that we have operated continuously since January 1, 2003 were $295.6 million and $281.7 million for the six months ended June 30, 2004 and June 30, 2003, respectively, an increase of 5%. This increase is due primarily to higher per diem charges to residents somewhat offset by a decrease in occupancy. Approximately 43% of our revenues from residents in the six months ended June 30, 2004 and 2003 were received from Medicare and Medicaid. Revenues from our pharmacy, which was acquired in September 2003, were $5.0 million for the six months ended June 30, 2004.

Interest and other income increased by $1.5 million in the six months ended June 30, 2004 to $1.7 million compared to $228,000 in the six months ended June 30, 2003 due to our settlement of litigation with Marriott which commenced about the time Marriott agreed to sell its senior living management business to Sunrise. On January 7, 2004, we and Senior Housing settled then pending litigation with Marriott. Under the terms of the settlement, Marriott paid to us and Senior Housing $1.3 million each.

Expenses for the six months ended June 30, 2004 were $303.0 million, an increase of 6% over expenses of $286.0 million for the six months ended June 30, 2003. Our wages and benefits costs increased from $154.3 million to $161.3 million, or 5%, primarily due to wage increases as well as wages related to three communities we began to operate on May 30, 2003 and the pharmacy we acquired in September 2003. Other operating expenses, which include utilities, housekeeping, dietary, maintenance, insurance and community level administrative costs, increased from $74.6 million to $79.9 million, or 7%, primarily as a result of increased charges from third parties, our operation of three additional properties on May 30, 2003 and our pharmacy acquisition in September 2003. Management fees related to the 30 communities managed for us by Sunrise for the six months ended June 30, 2004 and 2003, were $9.2 million and $8.5 million, respectively. The increase in fees at these 30 communities is the result of increased revenues at these communities. Rent expense to Senior Housing increased from $38.0 million to $40.6 million, or 7%, primarily due to the addition of three communities that we began to lease in May 2003, and additional rent for capital improvements that were funded by Senior Housing in 2003. Community level operating expenses related to the communities that we have operated throughout the six months ended June 30, 2004 and 2003 were $235.0 million and $228.6 million, respectively, an increase of 3%. This increase is primarily due to wage increases as well as increased charges from third parties.

Our general and administrative expenses for the six months ended June 30, 2004 were $9.9 million, an increase of 16% over expenses for the six months ended June 30, 2003 of $8.5 million, primarily due to costs resulting from our increased operations.

Depreciation expense for the six months ended June 30, 2004 was $1.8 million an increase of 6% over depreciation expense of $1.7 million for the six months ended June 30, 2003. This increase is primarily attributable to our purchase of furniture and fixtures related to the 30 communities which Sunrise manages offset by our sale of six communities in the second half of 2003.

Loss from discontinued operations for the six months ended June 30, 2004 was $574,000, a decrease of $125,000 over the loss for the six months ended June 30, 2003. This decrease is primarily the result of our ceasing operations at seven properties in the 2003 period compared with one property in the 2004 period.

As a result of the factors described above, our net income for the six months ended June 30, 2004 was $1.5 million compared to a loss of $4.5 million for the six months ended June 30, 2003. Our net income per share for the six months ended June 30, 2004 was $0.17 compared to a loss per share of $0.53 for the six months ended June 30, 2003.

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

The following tables present an overview of our portfolio for the years ended December 31, 2003 and 2002:

	2003	2002	Change
Revenues from residents (in 000s)	$ 575,986	$ 519,106	11%
Community expenses (in 000s)	$ 466,628	$ 417,301	12%
Total expenses (in 000s)	$ 583,782	$ 529,662	10%
No. of communities (end of period)	101	105	-4
No. of living units (end of period)	14,035	13,962	73
Occupancy	88%	89%	-1%
Average daily rate	$ 126	$ 114	11%
Revenue per day per available unit	$ 112	$ 102	10%
Percent of revenues from Medicare and Medicaid	39%	39%	
Percent of revenues from private / other	61%	61%	

"Same Store" Communities (communities that we operated continuously since January 1, 2002):

	2003	2002	Change
Revenues from residents (in 000s)	$ 236,667	$ 227,446	4%
Community expenses (in 000s)	$ 215,793	$ 210,645	2%
No. of communities (end of period)	53	53	
No. of living units (end of period)	4,868	4,868	
Occupancy	90%	89%	1%
Average daily rate	$ 148	$ 144	3%
Revenue per day per available unit	$ 133	$ 128	4%
Percent of revenues from Medicare and Medicaid	79%	78%	1%
Percent of revenues from private / other	21%	22%	-1%

Revenues from residents for 2003 were $576.0 million, an increase of 11% over revenues from residents of $519.1 million for 2002. This increase is attributable primarily to our beginning operations at 15 communities on October 26, 2002, and at three communities on May 30, 2003. Revenues from residents at the communities we operated throughout 2003 and 2002 were $236.7 million and $227.4 million, respectively, an increase of 4%. This increase is due primarily to higher per diem charges to residents and higher occupancy. About 39% of our revenues from residents in 2003 and 2002 were received from Medicare and Medicaid.

Interest and other income decreased by $68,000 in 2003 to $229,000 compared to $297,000 in 2002 due to lower cash balances and lower interest rates in 2003 partially offset by interest earned on mortgage notes receivable.

Expenses for 2003 were $583.8 million, an increase of 10% over expenses of $529.7 million for 2002. Our wages and benefits costs increased from $274.2 million to $315.6 million, or 15%, primarily due to expenses at the 18 communities we began to operate since October 2002 as well as increases in workers compensation and employee health insurance costs. Other operating expenses, which include utilities, housekeeping, dietary, maintenance, insurance and community level administrative costs, increased from $143.1 million to $151.0 million, or 6%, again primarily due to expenses at the 18 communities we began to operate since October 2002, as well as higher professional and general liability insurance costs. Management fees related to the 31 communities managed for us by Sunrise for 2003 and 2002, were $17.4 million and $16.6 million, respectively. This increase is primarily because these arrangements commenced on January 11, 2002, and, therefore, the 2003 period includes 11 more days than the 2002 period. Rent expense to Senior Housing increased from $75.2 million to $77.3 million, or 3%, primarily due to rents for communities we began to lease since October 2002, and rent increases which accompanied Senior Housing's purchase of improvements at leased communities, partially offset by a lease modification entered into on October 1, 2002 which changed the ownership of certain reserve accounts for future capital expenditures at the communities managed by Sunrise. Community level operating expenses related to the communities we operated throughout 2003 and 2002, were $215.8 million and $210.6 million, respectively, an increase of 2%. This increase is primarily due to increases in employee health, workers compensation and professional and general liability insurance costs.

Our general and administrative expenses for 2003 were $17.7 million, an increase of 15% over 2002 of $15.4 million, primarily due to costs resulting from our increased operations and to legal costs incurred in connection with our litigation with Marriott, which was settled in January 2004.

Depreciation expense in 2003 was $3.6 million, an increase of 95% over depreciation expense of $1.8 million in 2002. The increase is attributable to our purchase of seven communities in the second half of 2002 as well as capitalized improvements to some of our communities which increased our depreciable assets.

Loss from discontinued operations for 2003 was $372,000, a decrease of $2.5 million over the loss in 2002. This decrease is attributable to our dispositions of these operations as well as the recovery of some accounts receivable that were previously written off.

As a result of the factors described above, our net loss for 2003 was $7.9 million, compared to a loss of $13.2 million in 2002. Our net loss per share in 2003 was $0.94 compared to a loss per share of $1.74 in 2002.

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

The following tables present an overview of our portfolio for the years ended December 31, 2002 and 2001:

	2002	2001	Change
Revenues from residents (in 000s)	$ 519,106	$ 219,742	136%
Community expenses (in 000s)	$ 417,301	$ 201,447	107%
Total expenses (in 000s)	$ 529,662	$ 218,361	142%
No. of communities (end of period)	105	56	49%
No. of living units (end of period)	13,962	5,211	8,751
Occupancy	89%	90%	-1%
Average daily rate	$ 114	$ 130	-12%
Revenue per day per available unit	$ 102	$ 116	-12%
Percent of revenues from Medicare and Medicaid	39%	78%	-39%
Percent of revenues from private / other	61%	22%	39%

"Same Store" Communities (communities that we operated continuously since January 1, 2001):

	2002	2001	Change
Revenues from residents (in 000s)	$ 227,446	$ 219,742	4%
Community expenses (in 000s)	$ 210,645	$ 201,447	5%
No. of communities (end of period)	53	53	
No. of living units (end of period)	4,868	4,868	
Occupancy	89%	89	
Average daily rate	$ 144	$ 139	4%
Revenue per day per available unit	$ 128	$ 124	3%
Percent of revenues from Medicare and Medicaid	78%	78%	
Percent of revenues from private / other	22%	22%	

Revenues from residents for 2002 were $519.1 million, an increase of 136% over revenues from residents of $219.7 million for 2001. This increase is attributable primarily to our lease of 31 communities on January 11, 2002, our acquisition of five communities on April 1, 2002, and the 15 communities we began to operate in October 2002. Revenues from residents at the communities we operated throughout 2002 and 2001 were $227.4 million and $219.7 million, respectively, an increase of 4%. This increase is due primarily to higher per diem charges to residents. About 39% of our revenues from residents in 2002 were received from Medicare and Medicaid, compared to 78% in 2001. This decrease is due largely to the 31 communities and other communities we leased or acquired during 2002, all of which are focused on services to residents who pay with private resources.

Interest income increased by $205,000 in 2002 from $297,000 compared to $92,000 in 2001 due to earnings on higher cash balances in the 2002 period.

Expenses for 2002 were $529.6 million, an increase of 142% over expenses of $218.4 million for 2001. Our wages and benefits costs increased from $153.4 million to $274.2 million, or 78%, primarily due to expenses at the 51 communities we leased or acquired in 2002. Other operating expenses, which include utilities, housekeeping, dietary, maintenance, insurance and community level administrative costs, rose from $48.0 million to $143.1 million or 198%, again primarily due to expenses at the 51 communities we leased or acquired in 2002. During 2001, neither Marriott nor Sunrise managed any communities for us and we were a subsidiary of Senior Housing that did not lease any communities. As a result, we did not incur management fees or rent expense in 2001. Community level operating expenses related to the communities we operated throughout 2002 and 2001, were $210.6 million and $201.5 million, respectively, an increase of 5%. This increase is principally attributable to higher insurance premiums, an increase in reserves for the self funded portion of our insurance programs and higher wage and benefit costs, which were partially offset by a decrease in expenses from our reduced use of higher cost, third party staffing.

Our general and administrative expenses for 2002 were $15.4 million, a decrease of 1% over 2001, primarily due to operational start up costs incurred during 2001 which we did not incur in 2002 and which were only partially offset by increased costs in 2002 associated with operating as a separate, publicly owned company and the legal and other costs incurred in connection with our litigation with Marriott.

Depreciation expense in 2002 was $1.8 million, an increase of 38% over depreciation expense of $1.3 million in 2001. The increase is attributable to our purchase of 11 communities in 2002.

Loss from discontinued operations for 2002 was $2.9 million, an increase of $2.0 million over the loss in 2001. This increase was the result of reserves recorded for Medicaid receivables due from the State of Connecticut related to community closure costs and an asset impairment charge related to a closed community.

As a result of the factors described above, our net loss for 2002 was $13.2 million, compared to a profit of $527,000 in 2001. Our net loss per share in 2002 was $1.74. Assuming the shares outstanding as of December 31, 2001 were outstanding for all of 2001, our earnings per share would have been $0.12 for 2001.

LIQUIDITY AND CAPITAL RESOURCES

Our total current assets at June 30, 2004 were $68.4 million, compared to $59.7 million at December 31, 2003 and $48.3 million at December 31, 2002. At June 30, 2004 and December 31, 2003, we had cash and equivalents of $28.9 million and $21.2 million, respectively.

Our total current liabilities were $51.1 million at June 30, 2004, compared to $58.1 million at December 31, 2003 and $34.4 million at December 31, 2002. The decrease from December 31, 2003 to June 30, 2004 was due primarily to our repayment of amounts outstanding under our revolving credit facility and the payment of amounts due to Sunrise during the six months ended June 30, 2004. The increase from 2002 to 2003 was due to several factors. At December 31, 2003, we had $4.0 million outstanding under our revolving credit facility and there were no such outstanding amounts at December 31, 2002. In March 2004, we prepaid the amounts outstanding under our revolving credit facility. At December 31, 2003, we owed Senior Housing $6.6 million primarily related to our lease obligations. This amount was paid in January 2004. In addition, our accounts payable and accrued expenses and our accrued compensation and benefits increased primarily due to a change in the timing of certain current liabilities at the Sunrise managed communities as well as increases in our insurance reserves. Finally, the increase in amounts due to Sunrise was primarily due to Sunrise's not transferring cash amounts due to them on a timely basis.

As described in Note 1 to our audited financial statements, in 2003, information became available to us which resulted in $7.2 million of additional paid in capital. This amount was the result of our having received more working capital assets and having assumed fewer liabilities than we had previously recorded at the time of our spin off from Senior Housing.

Currently, we lease 97 communities from Senior Housing under two leases. Our leases with Senior Housing require us to pay a total of $82.2 million of minimum rent annually. Percentage rent on the leases begins in 2006. At October 21, we believe we are in compliance with the terms of these leases.

Our revenues from services to residents at our communities is the primary source of cash to fund operating expenses, including rent, principal and interest payments on our mortgage debt and capital expenditures. At some of our communities, operating revenues for nursing home services are received from the Medicare and Medicaid programs. For the six months ended June 30, 2004, 43% of our total revenues were derived from these programs. In 2003, 39% of our total revenues were derived from these programs. Medicare and Medicaid revenues were earned primarily from the 51 nursing home communities we lease from Senior Housing. Since 1998, a Medicare prospective payment system has generally lowered Medicare rates paid to senior living communities, including many of those that we operate. In October 2002, temporary increases in Medicare payment rates expired. In October 2003, Medicare rates increased by approximately 6%. Our Medicare revenues totaled $44.9 million during the first six months of 2004 and $86.1 million and $68.4 million during 2003 and 2002, respectively. Our Medicaid revenues totaled $73.9 million during the first six months of 2004 and $148.6 million and $142.6 million during 2003 and 2002, respectively. Some of the states in which we operate have not raised rates by amounts sufficient to offset increasing costs or are expected to reduce Medicaid funding. The magnitude of the potential Medicaid rate reductions cannot currently be estimated, but it may be material and may affect our future results of operations. Further Medicare and Medicaid rates declines may have a dramatic negative impact on our revenues and may produce greater losses.

We expect recent increases in the costs of insurance, especially tort liability insurance, workers compensation and employee health insurance, which are affecting the senior living industry, will continue to have a material adverse impact upon our future results of operations. As discussed in Note 15 to our audited financial statements and note 7 to our unaudited financial statements, a failure by Integrated Health Services, Inc. or the United States Department of Health and Human Services to make payments that we believe are due to us would have a material adverse impact upon our future results. Also, we believe Marriott's sale of its senior living management business to Sunrise has had, and may continue to have, an adverse impact on our financial results and has increased, and may continued to increase, our working capital requirements.

Also, prior to June 2004, pursuant to existing contract terms, a portion of our management fees payable to Sunrise were conditional, based on exceeding a threshold of net operating income that was not achieved and therefore was not being paid. As of July 2004, this portion of the management fee is no longer conditional and we will now be required to pay the full fee. We expect the annual amount of this additional management fee to be approximately $3.0 million per year. We expect improvements in our operations will offset this increased cost, but we can not be assured that our efforts in this regard will be successful.

Our revolving credit facility limits our ability to incur debt as more fully described below in "Debt Instruments and Covenants". The terms of our leases with Senior Housing contain provisions whereby Senior Housing may cancel our rights under these agreements upon the acquisition by any person or group of more than 9.8% of our voting stock, and upon other change of control events. These leases also limit our ability to create, incur, assume or guarantee indebtedness.

In August 2003, we sold a community in Seabury, Connecticut for $3.5 million, $3.15 million of which was in the form of a promissory note from the purchaser. This note is payable in monthly installments of $8,750 of principal, plus interest which accrues on the unpaid principal balance at a rate of 8% per year. This note matures on August 31, 2009, but we have the right to require prepayment as of August 31, 2008.

In December 2003, we sold group homes in Maryland for $3.55 million, $3.11 million of which was in the form of a promissory note from the purchaser. This note is payable in monthly installments of $1,700 of principal, plus interest which accrues on the unpaid principal balance at a rate of 9%. This note matures November 30, 2018, but we have the right to require prepayment earlier by giving notice after November 30, 2009.

During 2003, Senior Housing agreed to sell us two nursing homes in Michigan that we leased from Senior Housing. The purchase price is $10.5 million, the appraised value of the properties. On April 19, 2004, we purchased one of these properties from Senior Housing for $5.9 million. We financed this acquisition with proceeds we received from a new HUD insured mortgage and by using cash on hand. We expect the second purchase to occur in the fourth quarter of 2004 and we intend to finance the second sale with proceeds that we receive from a second HUD insured mortgage and with available cash. The remaining property is still leased from Senior Housing on a combined basis with 65 other properties. Under the terms of our lease with Senior Housing, upon completion of the sale, the annual rent payable under the combined lease is reduced by 10% of the sale prices we pay to Senior Housing.

On August 9, 2004, we entered into an agreement to acquire an institutional pharmacy located in Nebraska that services 24 senior living communities with approximately 1,450 beds for approximately $3.0 million. This acquisition was completed on September 1, 2004.

Despite the commitments, contingencies and limitations described above, we believe that a combination of our efforts to increase revenues and contain costs, our ability to borrow on our revolving credit facility, our ability to sell to Senior Housing certain capital improvements made to communities leased from Senior Housing and the possibility of sales or financings of our owned communities will be sufficient to meet our working capital needs, operating expenses, rent payments to Senior Housing, debt service and capital expenditures for the next 12 months and the foreseeable future.

As of June 30, 2004, our contractual obligations were as follows (dollars 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 obligations(1)	$ 4,958	$ 51	$ 111	$ 124	$ 4,672
Operating lease obligations(2)	1,079,365	81,986	163,973	163,973	669,433
Purchase obligations(3)	4,600	4,600			
Other long-term liabilities reflected on our balance sheet under GAAP(4)	23,905	5,672	9,791	6,965	1,477
Total	$ 1,112,828	$ 92,309	$ 173,875	$ 171,062	$ 675,582

(1) This amount represents amounts due under a HUD insured mortgage.

(2) These amounts represent minimum lease payments due to Senior Housing under two leases through 2017 and 2020.

(3) This amount represents our obligation to purchase a property from Senior Housing. This obligation is contingent upon our receiving HUD insured financing for a significant part of this purchase price. See also "Business Recent Developments" for a discussion of our agreement to acquire LTA which we entered into on September 23, 2004.

(4) These amounts include liabilities for continuing care contracts which require residents to make advance payments; some of these contracts are refundable and carried as liabilities until they are paid and some contracts are not refundable and are carried as liabilities until they are recognized as revenues over the periods during which we expect to provide the service. These amounts also include insurance reserves related to workers compensation and professional liability insurance as well as deferred gains related to property sales.

Debt Instruments and Covenants

In October 2002, we entered into a revolving credit facility. The interest rate on borrowings on this facility is LIBOR plus a spread. The maximum amount available under this facility is $12.5 million, and is subject to limitations based upon qualifying collateral. The borrower under this facility is a subsidiary that we organized with the intention that it be "bankruptcy-remote". Certain of our other subsidiaries sell or contribute their accounts receivable to the borrower on a true sale basis and make certain representations and other undertakings in favor of the borrower in connection with each sale. The seller subsidiaries have granted security interests in their assets to secure their obligations to the borrower. We guarantee the seller subsidiaries obligations to the borrower subsidiary and have pledged the stock or membership interests in each of the seller subsidiaries to the borrower. The borrower has in turn collaterally assigned these undertakings, guarantees and collateral to the revolving credit facility lenders, and has granted a security interest in the purchased receivables and all of its other assets to secure its obligations under the facility. The facility is available for acquisitions, working capital and general business purposes. The facility contains covenants and events of default requiring the maintenance of collateral, minimum net worth and certain other financial ratios, and places limits on our ability to incur or assume debt or create liens with respect to certain of our properties, and other customary provisions. The accounts receivable collateralizing the facility totaled approximately $20.0 million, net of allowances of $1.5 million, as of September 30, 2004. In certain circumstances and subject to available collateral and lender approvals, the maximum amounts which we may draw under this credit agreement may be increased to $25.0 million. The termination date of the facility is October 24, 2005. As of June 30, 2004 and October 21, 2004, no amounts were outstanding under the facility. At October 21, 2004 we believe we are in compliance with all applicable covenants under this revolving credit agreement and no amounts were outstanding under the facility.

As described above, on April 19, 2004, we purchased a property from Senior Housing for $5.9 million. We financed this acquisition with $5.0 million in proceeds we received from a new HUD insured mortgage and by using cash on hand. The interest cost on this debt is 5.6% per year. Principal and interest is due monthly through April 2039. This mortgage contains standard HUD mortgage covenants. At October 21, 2004 we believe we are in compliance with all material covenants of this mortgage.

Related Party Transactions

On December 31, 2001, Senior Housing distributed substantially all of its ownership of our shares to its shareholders. In order to effect this spin off and to govern relations after the spin off, we entered into agreements with Senior Housing, pursuant to which it was agreed, among other things, that:

- so long as Senior Housing remains a REIT, we may not waive the share ownership restrictions in our charter on the ability of any person or group to acquire more than 9.8% of any class of our equity shares without, among other requirements, the consent of Senior Housing and our determination that the exception to the ownership limitations would not cause a default under any of our leases;

- so long as we are a tenant of Senior Housing, we will neither permit any person or group to acquire more than 9.8% of any class of our voting stock or permit the occurrence of other change in control events, as defined, nor will we take any action that, in the reasonable judgment of Senior Housing or HRPT Properties Trust (another REIT which owns shares of Senior Housing), or HRPT, might jeopardize the tax status of Senior Housing or HRPT as a REIT;

- Senior Housing has the option, upon the acquisition by a person or group of more than 9.8% of our voting stock and upon other change in control events, as defined, to cancel all of our rights under the leases we have with Senior Housing; and

- so long as we maintain our shared services agreement with RMR or are a tenant under a lease with Senior Housing then we will not acquire or finance any real estate without first giving Senior Housing, HRPT, Hospitality Properties Trust, or HPT, or any other publicly owned REIT or other entity managed by RMR the opportunity to acquire or finance real estate investments of the type in which Senior Housing, HRPT, HPT or any other publicly owned REIT or other entity managed by RMR, respectively, invest.

At the time of our spin off from Senior Housing, all of the persons serving as our directors were trustees of Senior Housing. Two of our current directors, Messrs. Martin and Portnoy, are current managing trustees of Senior Housing.

As of October 21, 2004, we lease 97 senior living communities from Senior Housing for total annual minimum rent of $82.0 million. After giving effect to the LTA sale leaseback, we will lease 132 senior living communities for total minimum rent of $96.9 million.

During 2003, we and Senior Housing were jointly involved in litigation with Marriott, the operator of the senior living communities which we leased from Senior Housing. We and Senior Housing equally shared the costs of this litigation. This litigation was settled in January 2004.

Since we became a separate public company we have had and continue to have extensive business dealings with Senior Housing. Since January 1, 2002, we have entered or agreed to enter into several transactions with Senior Housing, including the following:

- During 2002, we acquired seven senior living communities from a third party for $27 million. Prior to this acquisition Senior Housing waived its right to acquire these assets, subject to a continuing right to acquire or finance these assets in the event we determine to sell or finance them. To finance the cash portion of our purchase, we sold a senior living community to Senior Housing, which we purchased in April 2002, for $12.7 million, its approximate carrying value. Simultaneous with our acquisition, Senior Housing acquired eight other senior living communities from the same third party. We acquired operating assets and liabilities related to these eight communities. We began to lease these eight communities and the community we sold to Senior Housing for minimum annual rent of $6.3 million. The terms of this transaction with Senior Housing were negotiated on our behalf by our independent director who is not on the board of Senior Housing.

- During 2002, we acquired FSQ, Inc., an entity owned by Messrs. Martin and Portnoy, in a merger transaction that was entered into as part of our spin off from Senior Housing. We acquired all of the stock of FSQ, Inc. and Messrs. Martin and Portnoy each received 125,000 of our common shares. The board of trustees of Senior Housing received an opinion from an internationally recognized investment banking firm, to the effect that the merger was fair, from a financial point of view, to us. The terms of this merger were approved by Senior Housing's trustees other than Messrs. Martin and Portnoy.

- During 2003, pursuant to the terms of our leases with Senior Housing, Senior Housing purchased $11.4 million of improvements to its properties leased by us, and the annual rent payable to Senior Housing was increased by 10% of the amounts invested, or $1.1 million.

- In May 2003, Senior Housing purchased from an unrelated third party three assisted living properties with 143 living units located in Virginia for $6.5 million. In September 2003, we sold Senior Housing one independent living property with 164 units in California for $12.3 million, its appraised value. These four properties were added to an existing lease with Senior Housing for nine other independent and assisted living properties. The minimum rent for the properties included in this lease was increased by $1.9 million per year. All other terms of the lease remained unchanged.

- In July 2003, we agreed to buy two nursing homes in Michigan that we leased from Senior Housing. The purchase price is $10.5 million, the appraised value of the properties. One of these purchases for $5.9 million closed on April 19, 2004 and we expect the second sale to close in the fourth of quarter 2004, which is contingent on our obtaining HUD insured financing for the property. The remaining property is still leased from Senior Housing on a combined basis with other nursing home properties. Under the terms of our lease with Senior Housing, upon completion of the sale, the annual rent payable under the combined lease is reduced by 10% of the net proceeds that Senior Housing received from the sale.

- On March 1, 2004, Senior Housing purchased from us one independent and assisted living community with 229 units located in Maryland. The purchase price was $24.1 million, the appraised value of the property. Simultaneous with this purchase, our existing leases with Senior Housing were modified as follows:

  - the lease for 53 nursing homes and the lease for 13 independent and assisted living communities were combined into one lease and the property acquired on March 1, 2004 was added to this combined lease;

the combined lease maturity date was changed to December 31, 2020 from December 31, 2018 and 2019 for the separate leases;

our minimum rent for the combined lease of 53 nursing homes and 14 independent living communities was increased by $2.4 million per year;

for all of our leases with Senior Housing, the amount of additional rent to be paid to Senior Housing was changed to 4% of the increase in revenues at the leased properties beginning in 2006. Prior to the lease combination, the percentage and the beginning time period for the nursing home lease and the independent and assisted living community lease was 3% and 2004 and 4% and 2005, respectively; and

all other lease terms remain substantially unchanged.

On September 23, 2004, we entered into a letter agreement with Senior Housing whereby Senior Housing agreed to loan us between $115 million and $117 million at the closing of our pending LTA acquisition. Such loan would be for up to 30 days and bear interest at a rate of 8% per annum. We expect to repay such loan, if incurred, with the proceeds we receive from a $165 million sale leaseback with Senior Housing for 35 of the 47 communities we acquire in the LTA acquisition.

In 2003, Senior Housing evicted a nursing home tenant that had defaulted on its obligations to Senior Housing. Until May 2004, we managed this nursing home for Senior Housing's account. Effective on May 1, 2004, we agreed with Senior Housing to add this nursing home to a multi-property lease from Senior Housing and to increase the annual rent by $180,000. All other lease terms remained unchanged.

One of the properties we lease from Senior Housing was subject to a ground lease with an unaffiliated third party. We are responsible for paying the ground rent of $307,000 per year. On June 3, 2004, Senior Housing exercised an option to purchase this land for $3,600,000 and acquired the landlord's rights and obligations under the ground lease. We now pay the ground rent to Senior Housing.

During 2004, pursuant to the terms of our leases with Senior Housing, we sold to Senior Housing $4.3 million of improvements we had made to its properties, and our annual rent payable to Senior Housing was increased by 10% of Senior Housing's purchase price amounts invested, or $432,000.

We obtained a workers compensation insurance policy for the year beginning June 15, 2003, from a third-party insurer. This third-party insurer ceded a portion of the premiums we paid to a Bermuda based company, Affiliates Insurers, Limited, or Affiliates, which was owned by RMR. Affiliates was organized by RMR to assist us in creating a partial self insurance program on an expedited basis. On December 8, 2003, we acquired Affiliates from RMR for an amount equal to RMR's cost of organizing and capitalizing that company, approximately $1.3 million.

Our Chief Executive Officer and Chief Financial Officer are also officers and employees of RMR. These officers devote a substantial majority of their business time to our affairs and the remainder to RMR's business which is separate from our business. We believe the compensation we pay to these officers reasonably reflects their division of business time; however, periodically, these individuals may divide their business time differently than they do currently and their compensation from us may become disproportionate to this division.

RMR provides investment, management and administrative services to us under a shared services agreement. RMR is compensated at an annual rate equal to 0.6% of our total revenues. Aggregate fees earned by RMR for services during 2002 and 2003 and in 2004 through September 30, were $2.9 million, $3.4 million and $2.7 million, respectively. The fact that RMR has responsibilities to other entities, including our landlord, Senior Housing, could create conflicts; and in the event of such conflicts between Senior Housing and us, the shared services agreement allows RMR to act on behalf of Senior Housing rather than on our behalf. RMR is owned by Messrs. Martin and Portnoy who are our managing directors. Messrs. Martin and Portnoy each have material interests in the transactions between us and RMR described above. All transactions between us and RMR are approved by our independent directors. Our independent directors have approved the renewal of the shared services agreement for its current term which will end December 31, 2004.

Messrs. Martin and Portnoy own the building in which our headquarters is located. Our lease for space was originally executed by FSQ, Inc. This lease expires in 2011. We paid rent under this lease during 2002 and 2003 and for the nine month period ending September 30, 2004 of $539,000, $569,000 and $423,000 respectively.

Until March 31, 1997, Mr. Portnoy was a partner of Sullivan & Worcester LLP, our counsel and counsel to Senior Housing, RMR and affiliates of each of the foregoing, and he received payments from that firm during 2002, 2003 and 2004 in respect of his retirement.

Critical Accounting Policies

Our critical accounting policies concern revenue recognition, our assessment of the net realizable value of our accounts receivable, the realizable value of long term assets, accounting for long term care contracts, accounting for business combinations and our assessment of reserves related to our self insurance programs.

Our revenue recognition policies involve judgments about Medicare and Medicaid rate calculation. These judgments are based principally upon our experience with these programs and our knowledge and familiarity with the current rules and regulations of these programs. We recognize revenues when services are provided and these amounts are reported at their estimated net realizable amounts. Some Medicare and Medicaid revenues are subject to audit and retroactive adjustment.

Our policies for valuing accounts receivable involve significant judgments based upon our experience, including consideration of the age of the receivable, the terms of the agreements with our residents or their third party payors, the residents or payors stated intent to pay, the residents or payors financial capacity and other factors which may include litigation or appeal proceedings.

We monitor our long-term assets to determine whether any impairment of these assets may have occurred. If the facts and circumstances indicate that an impairment may have occurred, we evaluate the asset's carrying value to determine whether an impairment charge is appropriate. This process includes a review of historical and projected future financial results realized or to be realized from the affected asset, market conditions affecting the sale of similar assets and the like. This process requires that estimates be made and errors in our judgments or estimates could have a material effect on our financial statements.

At certain of our communities, we offer long-term care contracts under which residents pay a one time amount in exchange for reduced charges during their stay. The one time amount may be refundable or non-refundable, or partially refundable and partially non-refundable. We record such amounts as a long term obligation and amortize the non-refundable portion of such amounts into revenue over our estimate of the periods during which future services will be provided. We base these estimates on our experience and actuarial information.

Since we became a separate public company on December 31, 2001 through October 21, 2004, we have acquired or leased a total of 54 communities. We accounted for each of these transactions as a purchase business combination in accordance with Statement of Financial Accounting Standards No. 141. Purchase accounting requires that we make certain judgments and estimates based on our experience, including determining the fair value and useful lives of assets acquired and the fair value of liabilities assumed. Some of our judgments and estimates are also based upon published industry statistics.

Our critical accounting policies for determining reserves for the self funded parts of our insurance programs involve significant judgments based upon our experience, including projected settlements for pending claims, known incidents which we expect may result in claims, estimates of incurred but not yet reported claims and incidents, our claims experience, estimated litigation costs and other factors. We also periodically receive and rely upon recommendations from professional consultants in establishing these reserves.

In the future we may need to revise the judgments, estimates and assessments we use to formulate our critical accounting policies to incorporate information which is not now known. We cannot predict the effect changes to these premises underlying our critical accounting policies may have on our future results of operations, although such changes could be material and adverse.

Inflation and Deflation

Inflation in the past several years in the U.S. has been modest. Future inflation might have both positive or negative impacts on our business. Rising price levels may allow us to increase occupancy charges to residents, but may also cause our operating costs to increase. Also our ability to increase rates paid by Medicare and Medicaid will be limited despite inflation.

Deflation would likely have a negative impact upon us. A large component of our expenses consist of minimum rental obligations to Senior Housing. Accordingly we believe that a general decline in price levels which could cause our charges to residents to decline would likely not be fully offset by a decline in our expenses.

Seasonality

Our business is subject to modest effects of seasonality. During the fourth calendar quarter holiday periods, residents of senior living communities are sometimes discharged to join family celebrations and admission decisions for new residents are often deferred. The first quarter of each calendar year usually coincides with increased illness among our communities' residents that can result in increased costs or discharges to hospitals. As a result of these factors, our operations sometimes produce greater earnings in the second and third quarters of a calendar year and lesser earnings in the first and fourth quarters. We do not believe that this seasonality will cause fluctuations in our revenues or operating cash flow to such an extent that we will have difficulty paying our expenses, including rent, which do not fluctuate seasonally.

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to risks associated with market changes in interest rates. We manage our exposure to this market risk through our monitoring of available financing alternatives. Other than as described below we do not now anticipate any significant changes in our exposure to fluctuations in interest rates or in how we manage this risk in the future. However, our exposure to fluctuations in interest rates may increase in the future if we incur debt to fund acquisitions or otherwise. As of October 21, 2004, we have no commercial paper, derivatives, swaps, hedges, joint ventures or partnerships.

Changes in market interest rates also affect the fair value of our debt obligations; increases in market interest rates decrease the fair value of our fixed rate debt, while decreases in market interest rates increase the fair value of our fixed rate debt. For example, based upon discounted cash flow analysis, if prevailing interest rates were to decline by 10% and other credit market considerations remained unchanged, the market value of our $5.0 million mortgage debt outstanding on June 30, 2004, would increase by approximately $353,000; and, similarly, if prevailing interest rates were to increase by 10%, the market value of this $5.0 million mortgage debt would decline by approximately $313,000.

Our revolving credit facility bears interest at floating rates and matures in October 2005. As of September 30, 2004, we had zero outstanding under this revolving credit facility. We borrow in U.S. dollars and borrowings under our revolving credit facility are subject to interest at LIBOR plus a spread. Accordingly, we are vulnerable to changes in U.S. dollar based short term rates, specifically LIBOR. A change in interest rates would not affect the value of any outstanding floating rate debt but would affect our operating results. For example, if the maximum amount of our credit facility of $12.5 million were drawn and interest rates increase or decrease by 1% per annum, our interest expense would increase or decrease by $125,000 per year, or $0.02 per share, respectively. If interest rates were to change gradually over time, the impact would be spread over time.

Business

GENERAL

We operate senior living communities, including independent living and congregate care communities, assisted living communities and nursing homes. As of October 21, 2004, we operated 101 communities containing 13,967 living units, including 49 primarily independent and assisted living communities containing 9,120 units and 52 nursing homes containing 4,847 units. Of our 49 primarily independent and assisted living communities, we lease 46 communities containing 8,727 units from Senior Housing, our former parent, including 30 communities which are directly operated for our account by Sunrise, and own and operate three communities containing 393 units. All but one of our nursing homes are leased from Senior Housing. Our 101 communities include 4,960 independent living apartments, 2,324 assisted living suites, 283 special care beds and 6,400 nursing beds. Our principal executive offices are located at 400 Centre Street, Newton, Massachusetts 02458, and our telephone number is (617) 796-8387.

OUR HISTORY

We were created by Senior Housing in April 2000 to operate nursing homes repossessed or acquired from two former Senior Housing tenants. We were reincorporated in Maryland on September 17, 2001. On December 31, 2001, Senior Housing distributed substantially all of our outstanding shares to its shareholders and we became a separate publicly owned company listed on the American Stock Exchange. Pursuant to the transaction agreement governing this spin off:

- Senior Housing capitalized us with approximately $50 million of equity, consisting of cash and working capital, primarily operating receivables, net of operating payables;
- we agreed to lease 31 primarily independent and assisted living communities operated by Marriott upon their acquisition by Senior Housing which occurred in 2002, as described below;
- we leased 53 nursing homes and two independent and assisted living communities from Senior Housing;
- we assumed one lease from the town of Campbell, Nebraska; and
- we agreed to acquire FSQ, Inc., the former operating company of the healthcare business we owned in order to acquire the personnel, systems and assets necessary for our business.

During 2002, we commenced operations at 51 senior living communities, including the 31 communities then operated by Marriott and currently operated by Sunrise, and 20 additional communities. Also during 2002, we ceased operations at two communities, one of which was previously leased from Senior Housing and one of which was previously leased from the town of Campbell, Nebraska.

During 2003, we commenced operations at three senior living communities, which we lease from Senior Housing. Also during 2003, we ceased operations at seven communities, one of which was previously leased from Senior Housing. During 2003, we also acquired an institutional pharmacy located in Wisconsin, we acquired a company insuring some of our risks, and we established certain self-insurance programs.

RECENT DEVELOPMENTS

On September 23, 2004, we entered into an agreement to acquire LTA for approximately $208 million. LTA is a privately owned company that owns and operates independent and assisted living communities in the southeastern United States. Pursuant to the agreement, we expect to acquire 47 senior living communities with 2,636 independent and assisted living units which are located in the following seven states:

State	Communities	Units
South Carolina	12	542
Tennessee	9	527
Virginia	5	483
North Carolina	4	351
Georgia	7	287
Alabama	6	253
Kentucky	4	193
Total	47	2,636

The majority of these communities were built by LTA between 1997 and 2002, and the average age of all 47 communities is approximately five years. As of June 30, 2004, these 47 communities were 85% occupied, and 100% of the revenues at these communities were paid by residents from their private resources.

To finance this acquisition, we intend to enter into a $165 million sale leaseback transaction with Senior Housing for 35 of the 47 communities that will be acquired from LTA. We intend to continue to operate those 35 communities and to retain ownership of the remaining 12 communities. We expect to fund the balance of the purchase price with cash on hand, and primarily by assuming HUD insured long term mortgage debt and a lease for four communities from Health Care Property Investors, Inc.

In addition to the 47 communities currently operated by LTA for its own account, LTA also manages 12 assisted living communities on behalf of third party owners. These 12 communities have 957 living units and are located in Florida (5 communities with 515 units), Georgia (5 communities with 334 units), Virginia (1 community with 56 units) and North Carolina (1 community with 52 units). We do not now know whether we will continue to manage these communities on a long-term basis.

Our business plan for the LTA communities is to increase revenues by increasing occupancy at the communities. We also expect to realize cost savings by combining the LTA operations with our existing operations. Of course, we can provide no assurances that the expected financial benefits from the LTA acquisition will be achieved.

Completion of our acquisition of LTA is subject to various conditions customary in transactions of this type, including licensing and receiving third party consents. Subject to satisfaction of these conditions, we expect this closing to occur during the fourth quarter of 2004, but there is no assurance that it will close.

On September 1, 2004, we acquired an institutional pharmacy business located in Lincoln, Nebraska for approximately $3 million.

OUR GROWTH STRATEGY

We believe that the aging of the U.S. population will increase demand for existing independent living properties, assisted living communities and nursing homes. Our principal growth strategy is to profit from this demand by operating such properties that provide high quality services to residents who pay with private resources. Since we became a separate public company through October 21, 2004, we added 49 primarily independent and assisted living communities to our business which generate 88% of their revenue from residents' private resources, rather than from Medicare or Medicaid.

Starting in the mid 1990s, a large number of independent and assisted living communities were developed with financing from private equity and real estate opportunity funds. We believe that many of these communities are now at or approaching stabilized operations and many of these financial investors are now anxious to sell. For example, in 2002 we acquired 15 independent and assisted living communities which were assembled and developed by Constellation Health Services, Inc., a division of Constellation Energy Group, Inc. f/k/a Baltimore Gas and Electric Company. The controlling shareholder of LTA, which we have agreed to acquire, is a private equity fund that was created by an investment bank. We expect to continue to pursue similar acquisitions for the next several years.

We also intend to expand our institutional pharmacy business. We acquired our first pharmacy in Waukesha, Wisconsin in 2003. As described in "Recent Developments", during 2004, we acquired a second pharmacy located in Lincoln, Nebraska. Whenever we buy an institutional pharmacy business we seek to grow its business by providing services at our senior living communities within the same service area. We are currently interested to acquire pharmacies in other areas where we own senior living communities. We can provide no assurances that we will be able to continue these pharmacy expansion activities, but we believe we will do so.

Our nursing homes derive a majority of their revenues from Medicare and Medicaid. In the future we may decide to expand our nursing home operations; however, if we do so, we expect to value such acquisitions at levels which take account of the risks we believe to be associated with Medicare and Medicaid revenues, particularly the risks that governmental fiscal policies may result in reduced Medicare and Medicaid rates or that such rates will not increase to match increasing costs of operations.

In addition, from time to time, we consider acquisition opportunities in service industries other than senior care, but we have no such considerations underway at this time.

TYPES OF COMMUNITIES

Our present business plan contemplates the ownership, leasing and management of independent living apartments or congregate care communities, assisted living communities, specialty care suites and nursing homes. Some communities combine more than one type of service in a single building or campus.

Independent Living Apartments or Congregate Care Communities

Independent living properties, or congregate care communities, provide high levels of privacy to residents and require residents to be capable of relatively high degrees of independence. An independent living apartment usually bundles several services as part of a regular monthly charge. For example, one or two meals per day in a central dining room, weekly maid service or a social director may be included in the base charge. Additional services are generally available from staff employees on a fee for service basis. In some independent living properties, separate parts of the community are dedicated to assisted living or nursing services. At September 30, 2004, our business included 4,960 independent living apartments in 38 communities.

Assisted Living Communities

Assisted living communities are typically comprised of one bedroom units which include private bathrooms and efficiency kitchens. Services bundled within one charge usually include three meals per day in a central dining room, daily housekeeping, laundry, medical reminders and 24 hour availability of assistance with the activities of daily living such as dressing and bathing. Professional nursing and healthcare services are usually available at the community on call or at regularly scheduled times. At September 30, 2004, our business included 2,324 assisted living suites in 41 communities.

Specialty Care Suites

Specialty care suites offer specialized programs for patients suffering from specific illnesses, usually Alzheimer's disease. At September 30, 2004, our business included 283 specialty care suites in 9 communities.

Nursing Homes

Nursing homes generally provide extensive nursing and healthcare services similar to those available in hospitals, without the high costs associated with operating theaters, emergency rooms or intensive care units. A typical purpose built nursing home includes mostly two bedrooms with a separate bathroom in each room and shared dining and bathing facilities. Some private rooms are available for those residents who can afford to pay higher rates or for residents whose medical conditions require segregation. Nursing homes are generally staffed by licensed nursing professionals 24 hours per day. At September 30, 2004, our business included 6,400 nursing home beds in 75 communities.

OPERATING STRUCTURE AND CORPORATE STAFFING

We have six regional offices, which are located in Maryland, Georgia, California, Wisconsin and two in Nebraska. Each regional office is responsible for up to 15 communities. Each region is headed by a regional director of operations with extensive experience in the senior living industry. Each regional office is typically supported by a clinical or wellness director, a rehabilitation services director, a regional accounts manager, a human resources specialist and a sales and marketing specialist. Regional staff are responsible for all our community operations within the region, including:

- resident services;
- marketing and sales;
- hiring of all community personnel;
- compliance with applicable legal and regulatory requirements; and
- supporting our development and acquisition plans within their region.

Our home office staff performs the following tasks:

- general oversight of our regional staff and pharmacy operations;
- the establishment of company wide policies and procedures relating to resident care;
- human resources policies and procedures;
- information technology;
- Medicare and Medicaid billing;
- licensing and certification maintenance;

legal services;

central purchasing;

budgeting and supervision of maintenance and capital expenditures;

implementation of our growth strategy; and

accounting and finance functions, including operations budgeting, accounts receivable and collections, accounts payable, payroll, general finance and accounting, and tax planning and compliance.

INDEPENDENT AND ASSISTED LIVING COMMUNITY STAFFING

Each of the independent and assisted living communities we operate for our own account has an executive director responsible for the day to day operations of the community, including quality of care, resident services, sales and marketing, financial performance and staff supervision. The executive director is supported by department heads, who oversee the care and service of the residents, a wellness director, who is responsible for coordinating the services necessary to meet the health care needs of our residents and a marketing director, who is responsible for selling our services. Other key positions include the dining services coordinator, the activities coordinator and the property maintenance coordinator.

NURSING HOME STAFFING

Each of our nursing homes is managed by a state licensed administrator who is supported by other professional personnel, including a director of nursing, an activities director, a marketing director, a social services director, a business office manager, and physical, occupational and speech therapists. Our directors of nursing are state licensed nurses who supervise our registered nurses, licensed practical nurses and nursing assistants. Staff size and composition vary depending on the size and occupancy of each nursing home and on the type of care provided by the nursing home. Our nursing homes also contract with physicians who provide certain additional medical services.

PHARMACY OPERATIONS AND STAFFING

Our pharmacy operations provide goods and services to operators and residents of senior living communities; we do not sell to the public generally. At our pharmacy we have an executive director who is a state licensed pharmacist, who manages the pharmacy and supervises billing. The executive director is responsible for the day to day operations of the business including sales and marketing, financial performance, monitoring state regulated codes regarding the dispensing of controlled substances and staff supervision. Other pharmacy personnel, include licensed dispensing pharmacists, a director of pharmacy consultation, medical records director, nurse consultant, pharmacy technicians and billing personnel.

OUR SENIOR LIVING COMMUNITIES

At October 21, 2004, our business included 101 senior living communities which may be categorized into three groups as follows:

		Type of Units							
Ownership	**No. of Communities**	**Indep. Living Apts.**	**Assist. Living Suites**	**Special Care Beds**	**Nursing Home Beds**	**Total Living Units**	**Occupancy at Sept. 30, 2004**	**Revenues for the three months ended Sept. 30, 2004 annualized (000s in thousands)**	**Percent of revenues from private resources**
Communities owned and operated by Five Star	4	250	143		149	542	85%	$ 19,190	50%
Communities leased from Senior Housing and operated by Five Star	67	733	695		4,690	6,118	89%	282,931	32%
Communities leased from Senior Housing and managed by Sunrise	30	3,977	1,486	283	1,561	7,307	90%	303,995	85%
Totals:	101	4,960	2,324	283	6,400	13,967	89%	$ 606,116	59%

COMMUNITIES OWNED AND OPERATED BY FIVE STAR

As of October 21, our business included four owned communities containing 393 independent and assisted living units and 149 nursing beds located in four states. The following table provides additional information about these communities and their operations:

		Type of Units						
Location	No. of Communities	Indep. Living Apts.	Assist. Living Suites	Nursing Home Beds	Total Living Units	Occupancy at Sept. 30, 2004	Revenues for the three months ended Sept. 30, 2004 annualized (000s in thousands)	Percent of revenues from private resources
1. Michigan	1			149	149	92%	$ 10,926	13%
2. Missouri	1	114			114	61%	1,534	100%
3. Nebraska	1		73		73	92%	2,281	100%
4. Florida	1	136	70		206	91%	4,449	100%
Totals:	4	250	143	149	542	85%	$ 19,190	50%

COMMUNITIES LEASED FROM SENIOR HOUSING AND OPERATED BY FIVE STAR

We operate 67 communities which are leased from Senior Housing. These communities contain 6,118 living units and are located in 15 states. The following table provides additional information about these communities and their operations.

		Type of Units						
Location	No. of Communities	Indep. Living Apts.	Assist. Living Suites	Nursing Home Beds	Total Living Units	Occupancy at Sept. 30, 2004	Revenues for the three months ended Sept. 30, 2004 annualized (000s in thousands)	Percent of revenues from private resources
1. Arizona	2		52	125	177	78%	$ 5,927	22%
2. California	6	84	165	397	646	93%	29,540	34%
3. Colorado	7	64		747	811	87%	42,505	24%
4. Connecticut	2			300	300	97%	22,310	8%
5. Georgia	3			338	338	91%	14,788	6%
6. Iowa	7	19		476	495	90%	25,581	16%
7. Kansas	2	140		55	195	84%	5,157	64%
8. Maryland	6	275	265	59	599	89%	21,399	100%
9. Michigan	1			124	124	89%	10,584	9%
10. Missouri	2			180	180	81%	6,383	19%
11. Nebraska	14			817	817	86%	33,643	30%
12. North Carolina	1		73	16	89	96%	3,323	100%
13. Virginia	5	143	140	12	295	92%	9,850	100%
14. Wisconsin	7			861	861	90%	43,899	21%
15. Wyoming	2	8		183	191	81%	8,042	23%
Totals:	67	733	695	4,690	6,118	89%	$ 282,931	32%

COMMUNITIES LEASED FROM SENIOR HOUSING AND MANAGED BY SUNRISE

Thirty of our communities are leased from Senior Housing and managed by Sunrise. These communities contain 7,307 living units and are located in 13 states. The following table provides additional information about these communities and their operations.

Location	No. of Communities	Type of Units: Indep. Living Apts.	Assist. Living Suites	Special Care Beds	Nursing Home Beds	Total Living Units	Occupancy at Sept. 30, 2004	Revenues for the three months ended Sept. 30, 2004 annualized (000s in thousands)	Percent of revenues from private resources
1. Arizona	3	522	143	28	188	881	90%	$ 33,309	86%
2. California	2	246	100		59	405	90%	20,049	86%
3. Delaware	5	335	173	26	341	875	94%	45,364	82%
4. Florida	5	885	331	0	95	1,311	88%	40,411	87%
5. Indiana	1	117		30	74	221	91%	11,233	79%
6. Kansas	1	117	30		60	207	97%	9,809	81%
7. Kentucky	3	380	55	0	171	606	95%	25,553	86%
8. Massachusetts	1		125			125	98%	6,829	88%
9. New Jersey	1	217	108	31	60	416	70%	13,793	95%
10. New Mexico	1	114	35		60	209	97%	10,530	86%
11. Ohio	1	144	87	25	60	316	88%	14,116	85%
12. South Carolina	1		60	36	68	164	93%	6,445	85%
13. Texas	5	900	239	107	325	1,571	90%	66,554	82%
Totals:	30	3,977	1,486	283	1,561	7,307	90%	$ 303,995	85%

OUR SENIOR HOUSING LEASES

We have two leases with Senior Housing, one for the communities that we operate and one for the communities managed by Sunrise. The material terms of these leases include the following:

Minimum Rent

Our minimum rent obligations for the communities we operate is $18.3 million per year, and for the communities managed by Sunrise is $63.9 million per year.

Percentage Rent

The additional rent for each lease is 4% of the amount by which total resident revenues of the properties under each lease starting in 2006 exceed the 2005 total resident revenues of the properties under each lease.

Term

The terms of these leases are as follows:

	Initial Expiration Date	Renewal Terms
Lease for communities operated by us	December 31, 2020	One 15 year renewal option.
Lease for communities managed by Sunrise	December 31, 2017	Two consecutive renewal options for 10 and 5 years (15 years total).

Operating Costs

Each lease is a so-called "triple-net" lease which requires us to pay all costs incurred in the operation of the communities, including the costs of personnel, service to residents, insurance and real estate and personal property taxes.

Rent During Renewal Term

Rent during each renewal term is the same as the minimum rent and percentage rent payable during the initial term.

Non Economic Circumstances

If we determine that continued operations of one or more communities is not economically practical, we may negotiate with Senior Housing to include a substitute property under the leases or close or sell that community, including Senior Housing's ownership in the property. In the event of such a sale, Senior Housing receives the net proceeds and our rent for the remaining communities in the affected lease is reduced according to formulas set forth in the leases.

Maintenance and Alterations

We are required to operate continuously and maintain, at our expense, the leased communities in good order and repair, including structural and nonstructural components. We may request Senior Housing to fund amounts needed for repairs and renovations in return for rent adjustments to provide Senior Housing a return on its investment according to formulas set forth in the leases. At the end of each lease term, we are required to surrender the leased communities in substantially the same condition as existed on the commencement date of the lease, subject to any permitted alterations and subject to ordinary wear and tear.

Assignment and Subletting

Senior Housing's consent is generally required for any direct or indirect assignment or sublease of any of the communities. In the event of any assignment or subletting, we will remain liable under the applicable lease.

Indemnification and Insurance

With limited exceptions, we are required to indemnify Senior Housing from all liabilities which may arise from the ownership or operation of the communities. We generally are required to maintain commercially reasonable insurance, including:

- "all-risk" property insurance, in an amount equal to 100% of the full replacement cost of the communities;
- business interruption insurance;
- comprehensive general liability insurance, including bodily injury and property damage, in amounts as are generally maintained by companies providing senior living services;
- flood insurance if any community is located in whole or in part in a flood plain;
- workers compensation insurance if required by law; and
- such additional insurance as may be generally maintained by companies providing senior living services, including professional and general liability insurance.

Each lease requires that Senior Housing be named as an additional insured under these policies.

Damage, Destruction, Condemnation and Environmental Matters

If any of the leased communities is damaged by fire or other casualty or taken for a public use, we are generally obligated to rebuild unless the community cannot be restored. If the community cannot be restored, Senior Housing will generally receive all insurance or taking proceeds and we are liable to Senior Housing for the amount of any deductible or deficiency between the replacement cost and the insurance proceeds, and our rent is adjusted pro rata. We are also required to remove and dispose of any hazardous substance at the leased communities in compliance with all applicable environmental laws and regulations.

Events of Default

Events of default under each lease include the following:

- our failure to pay rent or any other sum when due;
- our failure to maintain the insurance required under such lease;
- any person or group acquiring ownership of 9.8% of our outstanding voting stock or any change in our control or sale of a material portion of our assets without Senior Housing's consent;
- the occurrence of certain events with respect to our insolvency or dissolution;
- our being declared ineligible to receive reimbursement under Medicare or Medicaid programs for any of the leased communities which participate in such programs or the revocation of any material license required for our operations; and
- our failure to perform any terms, covenants or agreements of the leases and the continuance thereof for a specified period of time after written notice.

Remedies

Upon the occurrence of any event of default, each lease provides that, among other things, Senior Housing may, to the extent legally permitted:

- accelerate the rents;
- terminate the leases in whole or in part;
- enter the property and take possession of any and all our personal property and retain or sell the same at a public or private sale;
- make any payment or perform any act required to be performed by us under the leases; and
- rent the property and recover from us the difference between the amount of rent which would have been due under the lease and the rent received from the re-letting.

We are obligated to reimburse Senior Housing for all costs and expenses incurred in connection with any exercise of the foregoing remedies.

Management

We may not enter into any new management agreement or amend or modify any management agreement with Sunrise affecting any leased community without the prior written consent of Senior Housing.

Lease Subordination

Our leases may be subordinated to any mortgages on properties leased from Senior Housing.

Financing Limitations; Security

We may not incur debt secured by our investments in our tenant subsidiaries. Further, our tenant subsidiaries are prohibited from incurring liabilities other than operating liabilities incurred in the ordinary course of business, liabilities secured by our accounts receivables or purchase money debt. We are required to pledge 100% of the equity interests of our tenant subsidiaries to Senior Housing or its lenders, and we may pledge equity interests to our leases only if consented to by Senior Housing.

FF&E Reserves

We are required under our lease for the communities managed by Sunrise to make deposits into certain accounts that we own for replacements and improvements known as FF&E Reserves. Senior Housing has a security and remainder interest in these accounts and in all property purchased with funding from these accounts.

SUNRISE MANAGEMENT AGREEMENTS

The following is a description of the material terms of our management agreements with Sunrise:

Term

Generally each of the management agreements has an initial term expiring in 2027, with one five-year renewal term at Sunrise's option.

Community Services

Our contract with Sunrise delegates to Sunrise the responsibility for operations of the managed communities, including obtaining and maintaining all insurance, establishing resident care policies and procedures, carrying out and supervising all necessary repairs and maintenance, procuring food, supplies, equipment, furniture and fixtures, and establishing prices, rates and charges for services provided. Sunrise also recruits, employs and directs all community based employees.

Central Services

Sunrise also furnishes certain central administrative services, which are provided on a central or regional basis to all senior living communities managed by Sunrise. Such services include: (1) marketing and public relations; (2) human resources program development; (3) information systems development and support; and (4) centralized computer payroll and accounting.

FF&E Reserves and Capital Improvements

Sunrise has established an FF&E Reserve account under each management agreement to cover the expected recurring cost of replacements and renewals to the furniture, furnishings, fixtures, soft goods, case goods, vehicles and equipment, and for building repairs and maintenance which are normally capitalized. The FF&E Reserve accounts are funded from the operating revenues of the managed communities. The amount of this funding varies among the managed communities; however, for most communities it is currently set at 2.85% of gross revenues and will gradually increase to 3.5% of gross revenues. In 2003 we deposited $8.1 million into these accounts. In the event major capital improvements are required, or if the amounts set aside in the FF&E Reserve accounts are inadequate for required repairs, we may be required to separately fund such repairs and improvements. Any such separate funding which we provide increases the amount of our owner's priority, described below. The amount of FF&E Reserve funding required under our Sunrise management agreements is the same as the funding required by our Senior Housing lease for these communities. Also, under our lease we have the option to request Senior Housing to provide any required separate funding in return for rent adjustments to provide Senior Housing a return on its investment according to a formula set forth in the lease.

Fees

For its management services, Sunrise receives a base fee generally equal to 5% of the managed communities' gross revenues, plus an incentive fee generally equal to 20% of operating cash flows in excess of owner's priority amounts, as defined in the agreements. For its central services, SLS receives a fee generally equal to 2% of gross revenues. During 2003 and 2002 management and central services fees paid to Sunrise and Sunrise's predecessor, Marriott, totaled $17.4 million and $16.6 million, respectively.

Owners Priority

We receive the profits of the Sunrise managed communities on a priority basis before Sunrise receives any incentive fees. The amount of the owner's priority for each managed community is established based upon a specified rate of return on historical capital investments in these communities, including capital improvements during the term of the management agreements which are funded by us or Senior Housing in addition to the FF&E Reserve. For fiscal years 2003 and 2002, the aggregate amount of owner's priority for all communities managed by Sunrise was $69.4 million and $69.3 million, respectively.

Pooling

Twenty-nine of the communities are subject to pooling arrangements whereby the calculation and payment of FF&E Reserves, fees payable to Sunrise and owner's priority for several groups of these 29 communities are combined.

Defaults and Termination

The Sunrise management agreements contain various default and termination provisions. Our right to exercise termination options under the Sunrise management agreements is subject to approval by Senior Housing under the terms of the lease for these communities

GOVERNMENT REGULATION AND REIMBURSEMENT

Our operations must comply with numerous federal, state and local statutes and regulations. Also, the healthcare industry depends significantly upon federal and state programs for revenues and, as a result, is vulnerable to the budgetary policies of both the federal and state governments.

Independent Living Communities

Government benefits generally are not available for services at independent living communities and the resident charges in these communities are paid from private resources. However, a number of Federal Supplemental Security Income program benefits pay housing costs for elderly or disabled residents to live in these types of residential communities. The Social Security Act requires states to certify that they will establish and enforce standards for any category of group living arrangement in which a significant number of Supplemental Security Income residents reside or are likely to reside. Categories of living arrangements which may be subject to these state standards include independent living apartments and assisted living communities. Because independent living apartments usually offer common dining facilities, in many locations they are required to obtain licenses applicable to food service establishments in addition to complying with land use and life safety requirements. In many states, independent living apartment communities are licensed by state or county health departments, social service agencies or offices on aging with jurisdiction over group residential communities for seniors. To the extent that independent living apartments include units in which assisted living or nursing services are provided, these units are subject to applicable state licensing regulations, and if the communities receive Medicaid or Medicare funds, to certification standards. In some states, insurance or consumer protection agencies regulate independent living apartments in which residents pay entrance fees or prepay for services. One community which we acquired in 2002 includes 32 independent living apartments where rent rates are regulated by the requirement of a tax exempt bond financing.

Assisted Living Communities

According to the National Academy for State Health Policy, a majority of states provide or are approved to provide Medicaid payments for residents in some assisted living communities under waivers granted by the Federal Center for Medicare and Medicaid Services, or CMS, or under Medicaid state plans, and certain other states are planning some Medicaid funding by preparing or requesting waivers to fund assisted living demonstration projects. Because rates paid to assisted living community operators are generally lower than rates paid to nursing home operators, some states use Medicaid funding of assisted living as a means of lowering the cost of services for residents who may not need the higher intensity of health related services provided in nursing homes. States that administer Medicaid programs for assisted living communities are responsible for monitoring the services at, and physical conditions of, the participating communities. Different states apply different standards in these matters, but generally we believe these monitoring processes are similar to the concerned states' inspection processes for nursing homes.

In light of the large number of states using Medicaid to purchase services at assisted living communities and the growth of assisted living in recent years, a majority of states have adopted licensing standards applicable to assisted living communities. A majority of states have licensing statutes or standards specifically using the term "assisted living" and have requirements for communities servicing people with Alzheimer's disease or dementia. The majority of states have revised their licensing regulations recently or are reviewing their policies or drafting or revising their regulations. State regulatory models vary; there is no national consensus on a definition of assisted living, and no uniform approach by the states to regulating assisted living communities. Most state licensing standards apply to assisted living communities whether or not they accept Medicaid funding. Also, according to the National Academy for State Health Policy, a few states require certificates of need from state health planning authorities before new assisted living communities may be developed. Based on our analysis of current economic and regulatory trends, we believe that assisted living communities that become dependent upon Medicaid payments for a majority of their revenues may decline in value because Medicaid rates may fail to keep up with increasing costs. We also believe that assisted living communities located in states that adopt certificate of need requirements or otherwise restrict the development of new assisted living communities may increase in value because these limitations upon development may help ensure higher occupancy and higher non-governmental rates.

Two federal government studies and a recent report to a Senate committee by an assisted living working group provide background information and make recommendations regarding the regulation of, and the possibility of increased governmental funding for, the assisted living industry. The first study, an April 1999 report by the General Accounting Office to the Senate Special Committee on Aging on assisted living communities in four states, found a variety of residential settings serving a wide range of resident health and care needs. The General Accounting Office found that consumers often receive insufficient information to determine whether a particular community can meet their needs and that state licensing and oversight approaches vary widely. The General Accounting Office anticipates that as the states increase the use of Medicaid to pay for assisted living, federal financing will likewise grow, and these trends will focus more public attention on the place of assisted living in the continuum of long term care and upon state standards and compliance approaches. In June 2003, the General

Accounting Office recommended that CMS strengthen its oversight of state Medicaid waiver programs and quality assurance programs. The second study, a National Study of Assisted Living for the Frail Elderly, was funded by the U.S. Department of Health and Human Services Assistant Secretary for Planning and Evaluation and reported on the effects of different service and privacy arrangements on resident satisfaction, aging in place and affordability. In 2001, 2002 and 2003, the Senate Special Committee on Aging held hearings on assisted living and its role in the continuum of care and on community-based alternatives to nursing homes. In April 2003, an assisted living working group consisting of almost 50 organizations involved in assisted living, representing providers, consumers, accrediting and state regulatory organizations and others, provided a report to the Senate Special Committee on Aging. This workgroup could not agree on a definition for "assisted living" or on model standards, but presented recommendations on subjects ranging from staffing and funding to state regulatory approaches. We cannot predict whether these studies and reports will result in governmental policy changes or new legislation, or what impact any changes may have. Based upon our analysis of current economic and regulatory trends, we do not believe that the federal government is likely to have a material impact upon the current regulatory environment in which the assisted living industry operates unless it also undertakes expanded funding obligations, and we do not believe a materially increased financial commitment from the federal government is presently likely. However, we do anticipate that assisted living communities will increasingly be licensed and regulated by the various states, and that, in the absence of federal standards, the states' policies will continue to vary widely.

Nursing Homes-Reimbursement

About 64% of all nursing home revenues in the U.S. in 2002 (the most recent date for which information seems to be publicly available) came from publicly funded programs, including about 49% from Medicaid programs and 13% from the Medicare program. Nursing homes are among the most highly regulated businesses in the country. The federal and state governments regularly monitor the quality of care provided at nursing homes. State health departments conduct surveys of resident care and inspect the physical condition of nursing home properties. These periodic inspections and occasional changes in life safety and physical plant requirements sometimes require nursing home operators to make significant capital improvements. These mandated capital improvements have in the past usually resulted in Medicare and Medicaid rate adjustments, albeit on the basis of amortization of expenditures over expected useful lives of the improvements. A Medicare prospective payment system, or PPS, was phased in over three years beginning with cost reporting years starting on or after July 1, 1998. Under this Medicare payment system, capital costs are part of the prospective rate and are not community specific. This Medicare payment system and other recent legislative and regulatory actions with respect to state Medicaid rates are limiting the reimbursement levels for some nursing home services. At the same time federal and state enforcement and oversight of nursing homes are increasing, making licensing and certification of these communities more rigorous.

The current Medicare payment system was established by the Balanced Budget Act of 1997, and was intended to reduce the rate of growth in Medicare payments for skilled nursing communities. Before the current Medicare payment system, Medicare rates were community specific and cost-based. Under the current Medicare payment system, skilled nursing facilities receive a fixed payment for each day of care provided to residents who are Medicare beneficiaries. Each resident is assigned to one of 44 care groups depending on that resident's medical characteristics and service needs. Per diem payment rates are based on these care groups. Medicare payments cover substantially all services provided to Medicare residents in skilled nursing communities, including ancillary services such as rehabilitation therapies. The Medicare payment system is intended to provide incentives to providers to furnish only necessary services and to deliver those services efficiently. During the three year phase in period, Medicare rates for skilled nursing communities were based on a blend of community specific costs and rates established by the new Medicare payment system. According to the General Accounting

Office, between fiscal year 1998 and fiscal year 1999, the first full year of the changed Medicare payment system phase in, the average Medicare payment per day declined by about 9%.

Since November 1999, Congress has provided some relief from the impact of the Balanced Budget Act of 1997. Effective April 1, 2000, the Medicare, Medicaid and State Children's Health Insurance Program Balanced Budget Refinement Act of 1999 temporarily boosted payments for certain skilled nursing cases by 20% and allowed skilled nursing communities to transition more rapidly to the federal payment system. This Act also increased the Medicare payment rates by 4% for fiscal years 2001 and 2002 and imposed a two-year moratorium on some therapy limitations for skilled nursing patients covered under Medicare Part B. In December 2000, the Medicare, Medicaid and State Children's Health Insurance Program Benefits Improvement and Protection Act of 2000 was approved. Effective April 1, 2001 to October 1, 2002, this Act increased the nursing component of the payment rate for each care group by 16.66%. This Act also increased annual inflation adjustments for fiscal year 2001, increased rehabilitation care group rates by 6.7%, maintained the previously temporary 20% increase in the other care group rates established in 1999, and extended the moratorium on some therapy reimbursement rate caps through 2000. However, as of October 1, 2002, the 4% across the board increase in Medicare payment rates and the 16.66% increase in the nursing component of the rates expired. Effective October 1, 2003, CMS has increased the annual inflation update to skilled nursing community rates by 3% per year, and added an additional 3.26% for the year beginning October 1, 2003, to account for inflation underestimates in prior years. The 20% increase for the skilled nursing care groups and the 6.7% increase in rehabilitation care group rates will expire when the current resource utilization groups are refined. Effective December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 set a new moratorium on implementation of some therapy reimbursement rate caps through 2005.

Nursing Homes-Survey And Enforcement

CMS has undertaken an initiative to increase the effectiveness of Medicare and Medicaid nursing home survey and enforcement activities. CMS's initiative follows a July 1998 General Accounting Office investigation which found inadequate care in a significant proportion of California nursing homes and CMS's July 1998 report to Congress on the effectiveness of the survey and enforcement system. In 1999, the U.S. Department of Health and Human Services Office of Inspector General issued several reports concerning quality of care in nursing homes, and the General Accounting Office issued reports in 1999, 2000 and 2003 which recommended that CMS and the states strengthen their compliance and enforcement practices, including federal oversight of state actions, to better ensure that nursing homes provide adequate care. Since 1998, the Senate Special Committee on Aging has been holding hearings on these issues. CMS is taking steps to focus more survey and enforcement efforts on nursing homes with findings of substandard care or repeat violations of Medicare and Medicaid standards and to identify chain operated communities with patterns of noncompliance. CMS is also increasing its oversight of state survey agencies and requiring state agencies to use enforcement sanctions and remedies more promptly when substandard care or repeat violations are identified, to investigate complaints more promptly, and to survey communities more consistently. In addition, CMS has adopted regulations expanding federal and state authority to impose civil money penalties in instances of noncompliance. Medicare survey results and nursing staff hours per resident for each nursing home are posted on the Medicare website at www.medicare.gov. When deficiencies under state licensing and Medicare and Medicaid standards are identified, sanctions and remedies such as denials of payment for new Medicare and Medicaid admissions, civil monetary penalties, state oversight and loss of Medicare and Medicaid participation or licensure may be imposed. We receive notices of potential sanctions and remedies from time to time, and such sanctions have been imposed from time to time on us. If we are unable to cure deficiencies which have been identified or that are identified in the future, additional sanctions may be imposed, and if imposed, may adversely affect our ability to meet our financial obligations and negatively affect our financial condition and results of operations.

In 2000 and 2002 CMS issued reports on its study linking nursing staffing levels with quality of care, and CMS is assessing the impact that minimum staffing requirements would have on community costs and operations. In a report presented to Congress in 2002, the Department of Health and Human Services found that 90% of nursing homes lack the nurse and nurse aide staffing necessary to provide adequate care to residents. The Bush administration has indicated that it does not intend to impose minimum staffing levels or to increase Medicare or Medicaid rates to cover the costs of increased staff at this time, but CMS is now publishing the nurse staffing level at each nursing home on its internet site to increase market pressures on nursing home operators.

Federal efforts to target fraud and abuse and violations of anti-kickback laws and physician referral laws by Medicare and Medicaid providers have also increased. In March 2000, the U.S. Department of Health and Human Services Office of Inspector General issued compliance guidelines for nursing communities to assist them in developing voluntary compliance programs to prevent fraud and abuse. Also, new rules governing the privacy, use and disclosure of individually identified health information became final in 2001 and took effect in 2003, with civil and criminal sanctions for noncompliance. An adverse determination concerning any of our licenses or eligibility for Medicare or Medicaid reimbursement or the costs of required compliance with applicable federal or state regulations could adversely affect our ability to meet our financial obligations and negatively affect our financial condition and results of operations.

Nursing Homes-Certificates Of Need

Most states limit the number of nursing homes by requiring developers to obtain certificates of need before new communities may be built. Also, states such as California and Texas that have eliminated certificate of need laws often have retained other means of limiting new nursing home development, such as the use of moratoria, licensing laws or limitations upon participation in the state Medicaid program. We believe that these governmental limitations may make nursing homes more valuable by limiting competition.

Other Matters

Under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, Medicare beneficiaries may receive prescription drug benefits beginning in 2006 by enrolling in private health plans or managed care organizations, or if they remain in traditional Medicare, by enrolling in stand alone prescription drug plans. A number of legislative proposals that would affect major reforms of the healthcare system have been introduced in the U.S. Congress and many state governments, such as programs for national health insurance, the option of block grants for states rather than federal matching money for certain state Medicaid services, additional Medicare and Medicaid reforms and federal and state cost containment measures. In connection with recent fiscal pressures on state governments, legislation and regulation to reduce Medicaid nursing home payment rates in some states are possible in the future. We cannot predict whether any of these legislative or regulatory proposals will be adopted or, if adopted, what effect, if any, these proposals would have on our business.

INSURANCE

Litigation against senior living operators has been increasing during the past few years. Several cases by nursing home patients or their families who have won large monetary awards for mistreatment have been widely publicized. The amount of such litigation in Florida has been particularly significant. As a result, liability insurance costs are rising and, in some cases, such insurance is not available to some senior living operators. We have liability insurance for the properties which we now operate. Only one of these communities is located in Florida and the Florida community has no nursing home beds. Sunrise is responsible for obtaining insurance for the senior living communities which Sunrise manages for us. These communities include six in Florida (885 independent living apartments, 442 assisted living suites and 95 nursing home beds).

In recent years our insurance costs for workers compensation and employee healthcare have also increased significantly. This is especially so with respect to workers compensation insurance in California where we operate six communities with about 575 employees and where Sunrise operates for our account two communities with about 293 employees.

To partially offset these insurance cost increases, we have taken several actions including the following:

- we have increased the deductible or retention amounts for which we are liable under our liability insurance;
- we have established an offshore captive insurance company which participates in our liability insurance program. Some of our premiums for liability insurance are paid to this company which may retain some of these amounts and the earnings on these amounts based upon our actual claims experiences;
- we have acquired a different offshore insurance company and established a captive insurance program for our workers compensation insurance obligations in those states which permit such arrangements. This program may allow us to reduce our net workers compensation insurance costs by allowing us to retain the earnings on our reserves, provided our claims experience is as projected by various statutory and actuarial formulas;
- we have also increased the amounts which some of our employees are required to pay for health insurance coverage and as co-payments for health services and pharmaceutical prescriptions and decreased the amount of certain healthcare benefits;
- we have increased the deductible or retention amounts for our health insurance obligations;
- we have hired professional advisors to help us establish programs to reduce our insured workers compensation and professional and general liabilities, including a program to monitor and pro-actively settle liability claims and to reduce workplace injuries;
- we have hired professionals to help us establish appropriate reserves for our retained liabilities and captive insurance programs; and
- we have hired an asset manager for the Sunrise managed properties who, among other duties, monitors various insurance programs for these properties.

Our current insurance arrangements generally expire in June 2005. We do not know if our insurance charges and self-insurance reserve requirements will continue to increase, and we cannot now predict the amount of any such increase, or to what extent, if at all, we may be able to offset any increase through use of higher deductibles, retention amounts, self insurance or other means in the future.

COMPETITION

The senior living services business is highly competitive. We compete with service providers offering alternate types of services, such as home healthcare services, as well as other companies providing community based services. Our management team has been assembled within the past four years, and, although we believe it is experienced and highly talented, it does not have extensive experience working together. We expect we may expand our business with Senior Housing; however, Senior Housing is not obligated to provide us with opportunities to lease additional properties. We have large lease obligations and limited financeable assets. Many of our competitors have greater financial resources than we do. For all of these reasons and others, we cannot provide any assurance that we will be able to compete successfully for business in the senior living industry.

ENVIRONMENTAL MATTERS

Under various federal, state and local laws, owners as well as tenants and operators of real estate may be required to investigate and clean up hazardous substances released or otherwise present at a property, and may be held liable to a governmental entity or to third parties for property damage or personal injuries and for investigation and clean up costs incurred in connection with any such hazardous substances. Under our leases, we have also agreed to indemnify Senior Housing for any such liabilities related to the leased communities. In addition, some environmental laws create a lien on a contaminated site in favor of the government for damages and costs it incurs in connection with the contamination, which lien may be senior in priority to our leases. We have reviewed environmental surveys of our leased and owned communities. Based upon that review we do not believe that any of these properties are subject to any material environmental contamination. However, no assurances can be given that a prior owner, operator or occupant of our communities did not create a material environmental condition not known to us which might have been revealed by more in depth study of the properties; or future uses or conditions (including, without limitation, changes in applicable environmental laws and regulations) will not result in the imposition of environmental liability upon us. The presence or discovery of any material environmental contaminants could have a material adverse impact on us.

EMPLOYEES

As of October 13, 2004, we had approximately 7,232 employees, including 4,907 full time equivalents. Approximately 703 employees, including 484 full time equivalents, are represented under five collective bargaining agreements, all of which have remaining terms of one to three years. We have no other employment agreements. We believe our relations with our union and non-union employees are good.

INTERNET WEBSITE

Our internet address is www.5sqc.com. We make available, free of charge, through the "SEC Filings" tab under the "Financials" section of our internet website, our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such forms are electronically filed with the Securities and Exchange Commission, or SEC.

Any shareholder or other interested party who desires to communicate with our independent directors, individually or as a group, may do so by filling out a report at the "Governance" section of our website. Our board also provides a process for interested persons to send communications to the entire board. Information about the process for sending communications to our board can be found at the "Governance" section of our website.

Copies of our governance guidelines, code of ethics and the charters of our audit, quality of care, compensation and nominating and governance committees may be obtained free of charge by writing to our Secretary, Five Star Quality Care, Inc., 400 Centre Street, Newton, MA 02458 or at our website www.5sqc.com under the heading "Governance."

Our website address is included several times in this prospectus as a textual reference only. The information in the website is not incorporated by reference into this prospectus.

LEGAL PROCEEDINGS

In the ordinary course of business we are involved in litigation incidental to our business; however, we are not aware of any material pending legal proceeding affecting us for which we might become liable or the outcome of which we expect to have a material impact on us.

Management

The following sets forth the names, ages and positions of our executive officers and directors as of October 21, 2004:

Name	Age	Position
Evrett W. Benton	56	President, Chief Executive Officer and Secretary
Rosemary Esposito, RN	61	Senior Vice President, Chief Operating Officer
Maryann Hughes	56	Vice President, Director of Human Resources
Bruce J. Mackey Jr.	34	Treasurer, Chief Financial Officer and Assistant Secretary
Barry M. Portnoy	59	Managing Director (term will expire in 2005)
Gerard M. Martin	70	Managing Director (term will expire in 2006)
Bruce M. Gans, M.D.	57	Director (term will expire in 2007)
Barbara D. Gilmore	54	Director (term will expire in 2005)
Arthur G. Koumantzelis	74	Director (term will expire in 2006)

EXECUTIVE OFFICERS

Evrett W. Benton has been our President, Chief Executive Officer and Secretary since 2001. Mr. Benton served as President and Chief Executive Officer of FSQ, Inc. from 2000 until it was acquired by us in January 2002. From 1999 until FSQ, Inc. began operations in 2000, Mr. Benton served as a business and legal consultant to RMR and Senior Housing in connection with their negotiations with former tenants of Senior Housing. Since 2000, Mr. Benton has been a Vice President of RMR. From 1997 to 1999, Mr. Benton was an independent consultant working in the healthcare and real estate industries. Mr. Benton is an attorney, and prior to 1997 he served as general counsel and chief administrative officer of a large publicly held healthcare services company and as a practicing attorney.

Rosemary Esposito, RN has been our Senior Vice President and Chief Operating Officer since 2001. Ms. Esposito has also been our Chief Clinical Officer since June 2002. Ms. Esposito served as Senior Vice President and Chief Operating Officer of FSQ, Inc. from 2001 until it was acquired by us in January 2002. From 1999 to 2001, Ms. Esposito was Vice President and Chief Operating Officer of Lenox Healthcare, Inc., a company in the business of providing community based healthcare services. From 1996 to 1999, Ms. Esposito was Vice President of Clinical Services of Lenox Healthcare, Inc.

Maryann Hughes has been our Vice President and Director of Human Resources since 2001. Ms. Hughes served as a Vice President and Director of Human Resources for FSQ, Inc. from 2000 until it was acquired by us in January 2002. From 1996 to 2000, Ms. Hughes was Senior Vice President of Human Resources for Olympus Healthcare Group, Inc., a company in the business of providing community based healthcare services.

Bruce J. Mackey Jr. has been our Treasurer, Chief Financial Officer and Assistant Secretary since 2001. Mr. Mackey served as Treasurer and Chief Financial Officer of FSQ, Inc. from 2001 until it was acquired by us in January 2002. Mr. Mackey has been a Vice President of RMR since 2001 and has served in various capacities with RMR and its affiliates for over five years. Mr. Mackey is a certified public accountant.

DIRECTORS

Barry M. Portnoy has been one of our managing directors since 2001. Mr. Portnoy is also a managing trustee of HRPT, HPT and Senior Housing, and has been since 1986, 1995 and 2002, respectively. Mr. Portnoy was a director and 50% owner of FSQ, Inc. from 2000 until it was acquired by us in January 2002. Mr. Portnoy is chairman and 50% beneficial owner of RMR and of RMR Advisors, Inc., a registered investment advisor to mutual funds, including RMR Real Estate Fund and RMR Hospitality and Real Estate Fund, mutual funds where Mr. Portnoy has served as a managing trustee since 2003 and 2004, respectively. Mr. Portnoy is a Group I director and will serve until our 2005 annual meeting of shareholders.

Gerard M. Martin has been one of our managing directors since 2001. Mr. Martin is also a managing trustee of HRPT, HPT Senior Housing, and has been since 1986, 1995 and 1999, respectively. Mr. Martin was a director and 50% owner of FSQ, Inc. from 2000 until it was acquired by us in 2002. Mr. Martin is a director and 50% owner of RMR and of RMR Advisors, Inc., a registered investment advisor to mutual funds, including RMR Real Estate Fund and RMR Hospitality and Real Estate Fund, mutual funds where Mr. Martin has served as a managing trustee since 2005 and 2004, respectively. Mr. Martin is a Group II director and will serve until our 2006 annual meeting of shareholders.

Dr. Bruce M. Gans has been one of our directors since 2001. Dr. Gans has been Chief Medical Officer at Kessler Institute for Rehabilitation since June 2001. He is also a Professor of Physical Medicine and Rehabilitation at UMDNJ-New Jersey Medical School. From 1999 to 2001, Dr. Gans was Senior Vice President for Continuing Care and Chairman of Physical Medicine and Rehabilitation at North Shore Long Island Jewish Health System and Professor of Physical Medicine and Rehabilitation at the Albert Einstein College of Medicine in New York City. From 1989 to 1999, Dr. Gans was a Professor and chairman of the Department of Physical Medicine and Rehabilitation at Wayne State University and a Senior Vice President of the Detroit Medical Center. Dr. Gans was a trustee of HRPT from 1995 to 1999. Dr. Gans served as a trustee of Senior Housing from 1999 to 2001, when he resigned to join our board. Dr. Gans is a Group II director and will serve until our 2007 annual meeting of shareholders.

Barbara D. Gilmore has been one of our directors since January 2004. Ms. Gilmore has served as a clerk to the Honorable Joel B. Rosenthal of the United States Bankruptcy Court, Western Division of the District of Massachusetts, since August 2001. Ms. Gilmore was a partner at Sullivan & Worcester LLP from 1993 to 2000. Ms. Gilmore is also a registered nurse and practiced and taught nursing for several years before attending law school. Ms. Gilmore is a Group I director and will serve until our 2005 annual meeting of shareholders.

Arthur G. Koumantzelis has been one of our directors since 2001. Mr. Koumantzelis has been the President and Chief Executive Officer of Gainesborough Investments LLC, a private investment company, since June 1998. Mr. Koumantzelis is also a trustee of a number of privately held business trusts and has other business interests. Mr. Koumantzelis has been a trustee of HPT, RMR Real Estate Fund and RMR Hospitality and Real Estate Fund since 1995, 2003 and 2004, respectively. Mr. Koumantzelis was a trustee of Senior Housing from 1999 until his resignation in October 2003. Mr. Koumantzelis is a Group II director and will serve until our 2006 annual meeting of shareholders.

There are no family relationships among any of our directors or executive officers. Our executive officers serve at the discretion of our board.

COMPENSATION OF DIRECTORS

We pay each director other than Messrs. Martin and Portnoy an annual fee of $20,000, plus a fee of $500 for each board or committee meeting attended with a maximum fee of $1,000 per day. In addition, each director receives an annual grant of 4,000 of our common shares at the first meeting of our board following each annual meeting of shareholders. Board members are not separately compensated for serving on board committees; however, we pay the chairman of our audit committee an additional annual fee of $5,000, and the chairman of our governance committee and the chairman of our compensation committee an additional annual fee of $1,000 each, and the chairman of our quality of care committee an additional annual fee of $10,000. We reimburse directors for reasonable out-of-pocket expenses incurred in attending meetings of the board or board committees on which they serve. Messrs. Portnoy and Martin do not receive any cash compensation as directors or as members of board committees, but they do receive the annual share grants and they are reimbursed for their expenses.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

None of our Board members are employees of ours or an employee of any of our subsidiaries. In 2003 our board served as our compensation committee. In March 2004 we determined that our compensation committee would be comprised only of our independent directors. Other relationships between us and our directors are described under "Management's discussion and analysis of financial condition and results of operations Related Party Transactions."

EXECUTIVE COMPENSATION

The following table provides certain information concerning the compensation of our Chief Executive Officer and the other named executive officers for our past three fiscal years:

	Annual Compensation			Long Term Compensation
Name and Principal Position	**Year**	**Salary**	**Bonus**	**Restricted Share Awards**
Evrett W. Benton	2003	$ 200,000	$ 300,000	$ 35,000(1)
President, Chief Executive Officer and Secretary	2002	$ 200,000	$ 250,000	
	2001			$ 26,040(2)
Rosemary Esposito, RN	2003	$ 250,000	$ 50,000	$ 17,500(1)
Senior Vice President, Chief Operating Officer and Chief Clinical Officer	2002	$ 231,923	$ 40,000	
	2001			
Maryann Hughes	2003	$ 159,377	$ 35,000	$ 8,750(1)
Vice President and Director of Human Resources	2002	$ 140,962	$ 30,000	
	2001			
Bruce J. Mackey Jr.	2003	$ 189,619	$ 100,000	$ 17,500(1)
Treasurer, Chief Financial Officer and Assistant Secretary	2002	$ 127,692	$ 48,000	
	2001			

(1) All incentive share awards provide that one third of each award vests on the grant date and one third vests on or about each of the next two anniversaries following the grant. In the event an executive officer granted an incentive share award ceases to render significant services, whether as an employee or otherwise, to us, or to an affiliate of ours, the common shares which have not yet vested may be repurchased by us for nominal consideration. The dollar amounts shown in the table represent the vested and unvested total number of our common shares awarded during the year shown multiplied by the average high and low price for our common shares on the American Stock Exchange on the date of grant.

(2) We were a wholly owned subsidiary of Senior Housing until December 31, 2001. In 2001, Mr. Benton received a grant of 2,000 Senior Housing common shares. One third of the shares awarded in 2001 vested upon the grant date, one third vested in 2002 and the remaining one third vested in 2003. The dollar amounts shown represent the total number of vested Senior Housing common shares awarded during the year shown, multiplied by the closing price for the Senior Housing common shares on the New York Stock Exchange on the grant date.

Except with respect to incentive share awards under Senior Housing's 1999 Incentive Share Award Plan, neither we nor Senior Housing paid compensation to our executive officers during 2001. Their compensation for services to us and Senior Housing was paid by FSQ, Inc. and RMR.

Messrs. Benton and Mackey each devote a substantial majority of their business time to providing services as our officers and employees; however, Messrs. Benton and Mackey also dedicate some of their business time to providing services to RMR. Therefore, in addition to receiving compensation paid by us, each of Messrs. Benton and Mackey receive compensation for these separate services to RMR from RMR and some equity compensation from companies affiliated with RMR. None of our executive officers has an employment agreement with us or RMR.

OUR STOCK OPTION AND STOCK INCENTIVE PLAN

We have adopted the Five Star Quality Care, Inc. 2001 Stock Option and Stock Incentive Plan, or the Plan. Under the Plan, we are authorized to grant our employees, officers, directors and other individuals rendering services to us and our subsidiaries equity based awards, including incentive stock options, nonqualified stock options, common shares, restricted common shares and stock appreciation rights. The Plan is administered by our board compensation committee. The Plan provides that the compensation committee has the authority to select the participants and determine the terms of the awards granted under the Plan.

An unvested incentive award is not transferable by the recipient except by will or by the laws of descent and distribution. Nonqualified stock awards are transferable only to the extent provided in the agreement relating to such award. In the event that termination of employment is due to death or disability, the stock award is exercisable for a maximum of 12 months after such termination. The aggregate number of shares which may be issued under the Plan is 650,000, of which as of October 21, 2004, 91,000 have been issued.

If you want more information about this plan you should review the copy of the Plan which has been filed as an exhibit to the registration statement of which this prospectus is a part.

Principal Shareholders

The following table sets forth certain information regarding beneficial ownership of our common shares as of October 21, 2004 and as adjusted for this offering (assuming the underwriters do not exercise their over allotment option) of:

- each named executive officer;
- each of our directors;
- all directors and executive officers as a group; and
- each person or group known to us to be the beneficial owner of more than 5% of our common shares based on information available to us on October 21, 2004.

Unless otherwise indicated, each owner named below has sole voting and investment power for all common shares shown to be beneficially owned by that person or entity, subject to the matters set forth in the footnotes to the table below. The address of each named director and executive officer is c/o Five Star Quality Care, Inc., 400 Centre Street, Newton, Massachusetts 02458.

Our charter places restrictions on the ability of any person or group to acquire beneficial ownership of more than 9.8% (in number of shares or value, whichever is more restrictive) of any class of our equity shares. Additionally, the terms of our leases with Senior Housing and our agreement with RMR contain provisions whereby our rights under these agreements may be cancelled by Senior Housing and RMR, respectively, upon the acquisition by any person or group of more than 9.8% of our voting stock or upon other change in control events, as defined. If the breach of these ownership limitations causes a lease default, shareholders causing the default may become liable to us or to other shareholders for damages.

		Percentage of Shares Outstanding	
Name	**Number of Shares**	**Before Offering**	**After Offering**
Wells Fargo & Company(1)	840,491	9.8%	8.0%
Evrett W. Benton(2)	70,405	*	*
Rosemary Esposito(2)	10,000	*	*
Bruce M. Gans, M.D.(3)	6,190	*	*
Barbara D. Gilmore(3)	5,000	*	*
Maryann Hughes(2)	5,000	*	*
Arthur G. Koumantzelis(3)	6,225.6	*	*
Bruce J. Mackey Jr.(2)	10,018.2	*	*
Gerard M. Martin(3)(4)	178,371.9	2.1%	1.7%
Barry M. Portnoy(3)(4)	178,371.9	2.1%	1.7%
All directors and executive officers as a group (nine persons)(2)(3)(4)	469,582.6	5.5%	4.4%

* Less than 1%

(1) This information is presented as of June 30, 2004, and is based solely on a Form 13F filed with the SEC on August 13, 2004. These common shares are held by Wells Fargo & Company, a holding company, and certain of its subsidiaries. Wells Fargo & Company has reported that it has voting authority over 810,831 of such shares. The address of Wells Fargo & Company is 420 Montgomery Street, San Francisco, CA 94163.

(2) Includes the following common shares granted under our stock option and stock incentive plan which have not vested: Mr. Benton 13,333.33 common shares; Ms. Esposito 6,666.66 common shares; Ms. Hughes 3,333.33 common shares; and, Mr. Mackey 6,666.66 common shares.

(3) Includes the annual grant of 4,000 common shares as part of the annual compensation to each director.

(4) Messrs. Martin and Portnoy each directly own 131,000 common shares. Mr. Martin is the sole stockholder of a corporation which owns 12,371.9 common shares. Mr. Portnoy is the sole stockholder of a separate corporation which owns 12,371.9 common shares. Messrs. Martin and Portnoy are each 50% owners and directors of RMR, the investment manager to SNH. SNH, of which Messrs. Martin and Portnoy are managing trustees, owns 35,000 common shares. Under applicable regulatory definitions, Messrs. Martin and Portnoy may be deemed to have beneficial ownership of our shares owned by Senior Housing; however, Messrs. Martin and Portnoy disclaim beneficial ownership of our common shares owned by Senior Housing.

Description of capital stock

The following description of our capital stock and certain provisions of our charter and bylaws are summaries and are qualified by reference to our charter and our bylaws. Copies of these documents have been filed as exhibits to the registration statement of which this prospectus is a part.

Common Shares

Upon completion of the offering, we will have only one class of common stock, $.01 par value per share, or common shares, of which 20,000,000 shares will be authorized and 10,538,634 shares will have been issued. Our charter provides that our board, without any action by the shareholders, may amend the charter to increase or decrease the number of our authorized common shares. All of our shares issued in the offering will be duly authorized, fully paid and non-assessable.

The holders of common shares are entitled to one vote for each share held of record on our books for the election of directors and on all matters submitted to a vote of shareholders. The holders of common shares are entitled to receive ratably dividends, if any, when, as and if authorized by our board and declared by us out of assets legally available therefor, subject to any preferential dividend rights of any outstanding preferred shares. Upon our dissolution, liquidation or winding up, the holders of common shares are entitled to receive ratably our net assets available after the payment of all debts and other liabilities, subject to the preferential rights of any outstanding preferred shares. Holders of common shares have no preemptive, subscription, redemption, conversion or, if listed, appraisal rights. The rights, preferences and privileges of holders of common shares are subject to, and may be adversely affected by, the rights of the holders of shares of any class or series of preferred shares that we may designate and issue in the future. Our charter authorizes our board to reclassify any unissued common shares into other classes or series of stock and to establish the number of shares in each class or series and to set the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications or terms or conditions of redemption for each such class or series. Our charter and our bylaws contain certain provisions that could have the effect of delaying, deferring or preventing a change in our control. See " Material provisions of Maryland law, our charter and bylaws" below for a description of these provisions.

Preferred Shares

We have 1,000,000 shares of preferred stock, $0.01 par value per share, or preferred shares, authorized, of which 100,000 have been designated as junior participating preferred shares described below. Our board is authorized, without further vote or action by the shareholders, to issue from time to time preferred shares in one or more series and to classify or reclassify any unissued preferred shares and to reclassify any previously classified but unissued preferred shares of any series. Prior to issuance of shares of each series, our board is required by Maryland law and our charter to set, subject to the provisions of our charter regarding the restrictions on transfer of shares, the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each such series. Our charter provides that our board, without any action by the shareholders, may amend the charter to increase or decrease the number of our authorized preferred shares. The issuance of preferred shares could adversely affect the voting power of holders of common shares and the likelihood that such holders will receive dividend payments or payments upon liquidation and could have the effect of delaying, deferring or preventing a change in control. We believe that the ability of our board to issue one or more series of preferred shares provides us with flexibility in structuring possible future financings and acquisitions, and in meeting other corporate needs that may arise.

Junior Participating Preferred Shares

In connection with the adoption of our shareholders rights plan described below, our directors have established an authorized but unissued class of 100,000 preferred shares. See "Material provisions of Maryland law, our charter and bylaws Rights plan," for a summary of the shareholders' rights plan. Certain preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption of our junior participating preferred shares, when and if issued, are described below.

The following is a summary description of the material terms of the junior participating preferred shares. Because it is a summary, it does not contain all of the information that may be important to you. If you want more information, you should read our charter and bylaws, copies of which have been filed with the SEC. See "Where you can find more information."

The holder of each junior participating preferred share is entitled to quarterly dividends in the greater amount of $5.00 or 1,000 times the per share amount of all dividends, whether cash or otherwise, other than dividends payable in common shares, declared upon our common shares. Dividends on the junior participating preferred shares are cumulative. Whenever dividends on the junior participating preferred shares are in arrears, we may not declare or pay dividends, make other distributions on, or redeem or repurchase our common shares or other shares ranking on a parity with or junior to the junior participating preferred shares. If we fail to pay such dividends for six quarters, the holders of the junior participating preferred shares will be entitled to elect two directors.

The holder of each junior participating preferred share is entitled to 1,000 votes on all matters submitted to a vote of the shareholders, voting (unless otherwise provided in our charter or bylaws) together with holders of our common shares as one class. The junior participating preferred shares are not redeemable. Upon our liquidation, dissolution or winding up, the holders of our junior participating preferred shares are entitled to a liquidation preference of $1,000 per share plus the amount of any accrued and unpaid dividends, prior to payment of any distribution in respect of our common shares or any other shares ranking junior to the junior participating preferred shares. Following payment of this liquidation preference, the holders of junior participating preferred shares are not entitled to further distributions until the holders of our common shares have received an amount per share equal to the liquidation preference paid on the junior participating preferred shares divided by 1,000, adjusted to reflect events such as share splits, share dividends and recapitalizations affecting our common shares. Following the full payment of this amount to the common shareholders, holders of junior participating preferred shares are entitled to participate proportionately on a per share basis with holders of our common shares in the distribution of the remaining assets to be distributed in respect of shares in the ratio of one one thousandth of the liquidation preference to one, respectively. The preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption of the junior participating preferred shares are subject to the superior preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption of any senior series or class of our preferred shares which our board may, from time to time, authorize and issue.

Transfer Agent and Registrar

Our transfer agent and registrar for our common shares is EquiServe Trust Company, N.A.

Material provisions of Maryland law, our charter and bylaws

We are organized as a Maryland corporation. The following is a summary of our charter and bylaws and several provisions of Maryland law. Because it is a summary, it does not contain all the information that may be important to you. If you want more information, you should read our entire charter and bylaws, copies of which we have filed as exhibits to the registration statement of which this prospectus is a part, or refer to the provisions of applicable Maryland corporate law summarized below.

Restrictions on Share Ownership and Transfer

Our charter restricts the amount of shares that shareholders may own. These restrictions are intended to assist Senior Housing with REIT compliance under the IRC, and otherwise to promote our orderly governance. All certificates representing our shares will bear a legend referring to these restrictions.

Our charter provides that no person or group of persons acting in concert may own, or be deemed to own by virtue of the attribution provisions of the IRC, more than 9.8% of the number or value, whichever is more restrictive, of any class or series of our outstanding shares of capital stock. Any person who acquires, or attempts or intends to acquire, actual or constructive ownership of shares of our capital stock that will or may violate this 9.8% ownership limitation must give notice to us and provide us with other information that we may request.

The ownership limitations in our charter are effective against all of our shareholders. However, with the written consent of Senior Housing, our board may grant an exemption from the ownership limitation if it is satisfied that: (1) the shareholder's ownership will not cause us or any of our subsidiaries that are tenants of Senior Housing to be deemed a "related party tenant" under the IRC rules applicable to REITs; (2) the shareholder's ownership will not cause a default under any lease we have outstanding; and (3) the shareholder's ownership is otherwise in our best interests as determined by our board in the exercise of its business judgment.

If a person attempts a transfer of our shares in violation of the ownership limitations described above, then that number of shares which would cause the violation will be automatically transferred to a trust for the exclusive benefit of one or more charitable beneficiaries designated by us. The prohibited owner will not acquire any rights in the shares held in trust, will not benefit economically from ownership of the shares held in trust, will have no rights to distributions and will not possess any rights to vote the shares held in trust. This automatic transfer will be deemed to be effective as of the close of business on the business day prior to the date of the violative transfer.

Within 20 days after receiving notice from us that shares have been transferred to the trust, the trustee will sell the shares held in the trust to a person selected by the trustee whose ownership of the shares will not violate the ownership limitations. Upon this sale, the interest of the charitable beneficiary in the shares sold will terminate and the trustee will distribute the net proceeds of the sale to the prohibited owner and to the charitable beneficiary as follows:

The prohibited owner will receive the lesser of:

- the net price paid by the prohibited owner for the shares or, if the prohibited owner did not give value for the shares in connection with the event causing the shares to be held in the trust (e.g., a gift, devise or other similar transaction), the market price of the shares on the day of the event causing the shares to be transferred to the trust; and

- the net price received by the trustee from the sale of the shares held in the trust.

Any net sale proceeds in excess of the amount payable to the prohibited owner shall be paid to the charitable beneficiary.

If, prior to our discovery that shares of our capital stock have been transferred to the trust, a prohibited owner sells those shares, then:

- those shares will be deemed to have been sold on behalf of the trust; and to the extent that the prohibited owner received an amount for those shares that exceeds the amount that the prohibited owner was entitled to receive from a sale by the trustee, the prohibited owner must pay the excess to the trustee upon demand.

Also, shares of capital stock held in the trust will be offered for sale to us, or our designee, at a price per share equal to the lesser of:

the price per share in the transaction that resulted in the transfer to the trust or, in the case of a devise or gift, the market price at the time of the devise or gift; and

the market price on the date we or our designee accepts the offer.

We will have the right to accept the offer until the trustee has sold the shares held in the trust. The net proceeds of the sale to us will be distributed similar to any other sale by the trustee.

Every owner of 5% or more of any class or series of our shares may be required to give written notice to us within 30 days after the end of each taxable year stating the name and address of the owner, the number of shares of each class and series of our shares which the owner beneficially owns, and a description of the manner in which those shares are held. In addition, each shareholder is required to provide us upon demand with any additional information that we may request in order to assist us and Senior Housing in its determination of its status as a REIT and to determine and ensure compliance with the foregoing share ownership limitations.

The restrictions described above will not preclude the settlement of any transaction entered into through the facilities of the American Stock Exchange or any other national securities exchange or automated inter-dealer quotation system. Our charter provides, however, that the fact that the settlement of any transaction occurs will not negate the effect of any of the foregoing limitations and any transferee in this kind of transaction will be subject to all of the provisions and limitations described above.

These ownership limitations could have the effect of delaying, deferring or preventing a takeover or other transaction in which holders of some, or a majority, of our common shares might receive a premium for their shares over the then prevailing market price or which such holders might believe to be otherwise in their best interest.

Possible Liability of Shareholders for Breach of Restrictions on Ownership

Our community leases and our shared services agreement are terminable by Senior Housing and RMR, respectively, in the event that any shareholder or group of shareholders acting in concert becomes the owner of more than 9.8% of our voting stock without Senior Housing's consent. If a breach of the ownership limitations results in a lease default, the shareholders causing the default may become liable to us or to our other shareholders for damages. These damages may be in addition to the loss of beneficial ownership and voting rights, the transfer to a trust and the forced sale of excess shares described above. These damages may be for material amounts.

Directors

Our charter and bylaws provide that our board has the exclusive power to establish the number of directors. However, there may not be less than the minimum number required by Maryland law nor more than seven directors. In the event of a vacancy, a majority of the remaining directors will fill the vacancy and the director elected to fill the vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred.

Our charter divides our board into three classes. Shareholders elect directors of each class for three-year terms upon the expiration of their current terms. Shareholders will elect only one class of directors each year. There is no cumulative voting in the election of directors. Consequently, at each annual meeting of shareholders, a majority of the votes entitled to be cast will be able to elect all of the successors of the class of directors whose term expires at that meeting.

We believe that classification of our board helps to assure the continuity of our business strategies and policies. However, our classified board also has the effect of making the replacement of our incumbent directors more time consuming and difficult. At least two annual meetings of shareholders are generally required to effect a change in a majority of our board.

Our charter provides that a director may be removed only for cause by the affirmative vote of at least 75% of the shares entitled to vote in the election of directors. This provision precludes shareholders from removing incumbent directors unless they can obtain a substantial affirmative vote of shares.

Advance Notice of Director Nominations and Other Business

Our bylaws provide that nominations of persons for election to our board and other business may only be considered at our shareholders meetings if the nominations or other business are included in the notice of the meeting, made or proposed by our board or made or proposed by a shareholder who:

- is a shareholder of record at the time of giving notice of the nomination or the business to be considered;
- is a shareholder of record entitled to vote at the meeting at which the nomination or business is to be considered;
- is a shareholder of record at the time of the meeting; and
- has complied in all respects with the advance notice provisions for shareholder nominations and other business set forth in our bylaws.

Under our bylaws, a shareholder's notice of nominations for director or business to be transacted at an annual meeting of shareholders must be delivered to our secretary at our principal office not later than the close of business on the 90th day and not earlier than the close of business on the 120th day prior to the first anniversary of the date of mailing of our notice for the preceding year's annual meeting. In the event that the date of mailing of our notice of the annual meeting is advanced or delayed by more than 30 days from the anniversary date of the mailing of our notice for the preceding year's annual meeting, a shareholder's notice must be delivered to us not earlier than the close of business on the 120th day prior to the mailing of notice of such annual meeting and not later than the close of business on the later of: (1) the 90th day prior to the date of mailing of the notice for an annual meeting, or (2) the 10th day following the day on which we first make a public announcement of the date of mailing of our notice for such meeting. The public announcement of a postponement of the mailing of the notice for an annual meeting or of an adjournment or postponement of an annual meeting to a later date or time will not commence a new time period for the giving of a shareholder's notice. If the number of directors to be elected to our board at a shareholders meeting is increased and we make no public announcement of such action or do not specify the size of the increased board at least 130 days prior to the first anniversary of the date of mailing of notice for our preceding year's annual meeting, a shareholder's notice also will be considered timely, but only with respect to nominees for any new positions created by such increase, if the notice is delivered to our secretary at our principal office not later than the close of business on the 10th day following the day on which such public announcement is made. This provision does not apply to new directors who are elected by the board to fill a vacancy, including a vacancy created by board action which increases the number of directors.

For special meetings of shareholders, our bylaws require a shareholder who is nominating a person for election to our board at a special meeting at which directors are to be elected to give notice of such nomination to our secretary at our principal office not earlier than the close of business on the 120th day prior to such special meeting and not later than the close of business on the later of: (1) the 90th day prior to such special meeting or (2) the 10th day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by the directors to be elected at such meeting. The public announcement of a postponement or adjournment of a special meeting to a later date or time will not commence a new time period for the giving of a shareholder's notice as described above.

Any notice from a shareholder of nominations for director or business to be transacted at a shareholders meeting must be in writing and include the following:

- as to each person nominated for election or reelection as a director, (1) the person's name, age, business and residence addresses, (2) the class and number of shares beneficially owned or owned of record by the person, (3) the date such shares were acquired and the investment intent of such acquisition; (4) the record of all purchases and sales of our securities by the person during the previous 12 month period, including the date of the transactions, the class, series and number of securities involved in the transactions and the consideration involved, and (5) all other information relating to the person that is required to be disclosed in solicitations of proxies for election of directors or otherwise required by Regulation 14A under the Securities Exchange Act of 1934, as amended, together with the nominee's written consent to being named in the proxy statement as a nominee and to serving as a director if elected;

- as to other business that the shareholder proposes to bring before the meeting, a brief description of the business, the reasons for considering the business and any interest in the business of the shareholder giving the notice and of the beneficial owner, if any, on whose behalf the proposal is made;

- as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made, the name and address of the shareholder and beneficial owner and the class and number of each class of our shares of capital stock which (s) he or they own beneficially and of record;

- as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made, the record of all purchases and sales of our securities by such shareholder or beneficial owner during the previous 12 month period including the date of the transactions, the class, series and number of securities involved in the transactions and the consideration involved; and

- to the extent known by the shareholder giving the notice, the name and address of any other shareholder supporting the nominee for election or reelection as a director or the proposal of other business on the date of such shareholder's notice.

If any shareholder nomination or proposal would cause us to be in breach of any covenant in any of our existing or proposed debt instruments or agreements, the proponent shareholder must submit to our secretary evidence satisfactory to our board of the lender's or contracting party's willingness to waive the breach of covenant or a plan for repayment of the indebtedness to the lender or correcting the contractual default, specifically identifying the actions to be taken or the source of funds to be used in the repayment, which plan must be satisfactory to our board. If any shareholder nomination or proposal could not be implemented by us without notifying or obtaining the consent or approval of any federal, state, municipal or other regulatory body, the proponent shareholder must submit to our secretary evidence satisfactory to our board that any and all required notices, consents or approvals have been given or obtained or a plan for making the requisite notices or obtaining the requisite consents or approvals prior to the implementation of the proposal or election, which plan must be satisfactory to our board of directors.

We may request that any shareholder proposing a nominee for election to our board provide, within three business days of such request, written verification of the accuracy of the information submitted by the shareholder. Our board may also require any nominee to agree in writing with regard to matters of business ethics and confidentiality while such nominee serves as a director.

Meetings of Shareholders

The board determines the place and time of the annual meeting of shareholders. Special meetings of shareholders may only be called by the majority of the board, the chairman of the board, if any, or the president, or, if permitted under Maryland law and our charter and bylaws, upon the written request of shareholders entitled to cast not less than a majority of all the votes entitled to be cast at that meeting (or such greater proportion we are permitted to specify under Maryland law).

Liability and Indemnification of Directors and Officers

Maryland corporate law permits a Maryland corporation to include in its charter a provision eliminating the liability of its directors and officers to the corporation and its shareholders for money damages except for liability resulting from (1) actual receipt of an improper benefit or profit in money, property or services or (2) acts committed in bad faith or active and deliberate dishonesty established by a final judgment as being material to the cause of action. Our charter contains such a provision which eliminates such liability to the maximum extent permitted by Maryland law.

In accordance with Maryland corporate law, our charter authorizes us, to the maximum extent permitted by Maryland law, to obligate ourselves to indemnify and to pay or reimburse reasonable expenses in advance of final disposition of a proceeding to (1) any present or former director or officer or (2) any individual who, while a director and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise, from and against any claim or liability to which he or she may become subject or which he or she may incur by reason of his or her service in any such capacity. Our bylaws obligate us, to the maximum extent permitted by Maryland law, to indemnify and to pay or reimburse reasonable expenses in advance of final disposition of a proceeding to (a) any present or former director or officer who is made party to the proceeding by reason of his or her service in that capacity or (b) any individual who, while a director, at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or any other enterprise as a director, officer, partner or trustee of such corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise and who is made a party to the proceeding by reason of his or her service in that capacity. Our charter and bylaws also permit us to indemnify and advance expenses to any person who served a predecessor of ours in any of the capacities described above and to any employee or agent of ours or a predecessor of ours.

The Maryland corporation statutes require a corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made or threatened to be made a party by reason of his or her service in that capacity. The Maryland corporation statutes permit a corporation to indemnify its directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceedings to which they may be made or are threatened to be made a party by reason of their service in those or other capacities unless it is established that:

- the act or omission of the director or officer was material to the matter giving rise to the proceedings and (a) was committed in bad faith or (b) was the result of active and deliberate dishonesty;

- the director or officer actually received an improper personal benefit in money, property or services; or

- in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful.

However, under the corporation statutes of Maryland, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that personal benefit was improperly received, unless in either case a court orders indemnification and then only for expenses. In accordance with Maryland corporate law, our bylaws require us, as a condition to advancing expenses, to obtain:

- a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification by us as authorized by our bylaws; and

- a written statement by him or her or on his or her behalf to repay the amount paid or reimbursed by us if it shall ultimately be determined that the standard of conduct was not met.

In addition, we have entered into indemnification agreements with each of our directors and executive officers that provide procedures and remedies to give contractual assurance that the indemnification protection under Maryland law as in effect on the dates of such agreements will be available.

Charter Amendments and Extraordinary Transactions

Under Maryland corporate law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business unless the transaction or amendment is declared advisable by the board of directors and then approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter unless a lesser percentage (but not less than a majority of all of the votes entitled to be cast on the matter) is set forth in the corporation's charter. Our charter provides for approval of such matters when they are first declared advisable by our board and then approved by the affirmative vote of stockholders entitled to cast a majority of the votes entitled to be cast on the matter (or such lesser proportion, as is permitted by Maryland law).

Bylaw Amendments

As permitted under Maryland corporate law, our bylaws provide that our board has the exclusive power to amend the bylaws.

Business Combinations

The Maryland corporation statutes contain a provision which regulates business combinations with interested shareholders. Under Maryland corporate law, business combinations such as mergers, consolidations, share exchanges and the like between a Maryland corporation and an interested shareholder or an affiliate of the interested shareholder are prohibited for five years after the most recent date on which the shareholder becomes an interested shareholder. Under the statute, the following persons are deemed to be interested shareholders:

- any person who beneficially owns 10% or more of the voting power of the corporation's shares of capital stock; or an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then outstanding voting shares of the corporation.

A person is not an interested shareholder under the statute if the board of directors approved in advance the transaction by which the person otherwise would have become an interested shareholder. The board of directors may provide that its approval is subject to compliance with any terms and conditions determined by the board of directors.

After the five-year prohibition period has ended, a business combination between a corporation and an interested shareholder or an affiliate of the interested shareholder must be recommended by the board of directors of the corporation and must receive the following shareholder approvals:

the affirmative vote of at least 80% of the votes entitled to be cast by the corporation's outstanding voting shares; and

the affirmative vote of at least two-thirds of the votes entitled to be cast by holders of voting shares other than voting shares held by the interested shareholder with whom or with whose affiliate the business combination is to be effected or by an affiliate or associate of the interested shareholder.

These shareholder approvals are not required if the corporation's shareholders receive the minimum price set forth in the Maryland corporation statute for their shares of capital stock and the consideration is received in cash or in the same form as previously paid by the interested shareholder for its shares of capital stock.

The foregoing provisions of Maryland corporate law do not apply, however, to business combinations that are approved or exempted by the board of directors of the corporation prior to the time that the interested shareholder becomes an interested shareholder. Our board has adopted a resolution that any business combination between us and any other person is exempted from the provisions of the Maryland corporation statutes described in the preceding paragraph, provided that the business combination is first approved by our board, including the approval of a majority of the members of our board who are not affiliates or associates of such person. This resolution, however, may be altered or repealed in whole or in part at any time.

Control Share Acquisitions

Maryland law provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent that the acquisition is approved by a vote of two-thirds of the votes entitled to be cast on the matter, excluding shares of capital stock owned by the acquiror, by employees who are also directors of the corporation or by officers of the corporation. Control shares are voting shares of capital stock which, if aggregated with all other shares of capital stock previously acquired by the acquiror, or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing directors within one of the following ranges of voting power:

one-tenth or more but less than one-third;

one-third or more but less than a majority; or

a majority or more of all voting power.

An acquiror must obtain the necessary shareholder approval each time he acquires control shares in an amount sufficient to cross one of the thresholds noted above.

Control shares do not include shares which the acquiring person is entitled to vote as a result of having previously obtained shareholder approval. A control share acquisition means the acquisition of control shares. There is a statutory list of exceptions from the definition of control share acquisition.

A person who has made or proposes to make a control share acquisition, upon satisfaction of the conditions set forth in the statute, including an undertaking to pay expenses, may compel the board of directors of the corporation to call a special meeting of shareholders to be held within 50 days after demand to consider the voting rights of the shares. If no request for a meeting is made, the corporation may itself present the matter at a shareholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the corporation may redeem any or all of the control shares for fair value determined as of the date of the last control share acquisition by the acquiror or of any meeting of shareholders at which the voting rights of those shares are considered and not approved. The right of the corporation to redeem any or all of the control shares is subject to conditions and limitations listed in the statute. The corporation may not redeem shares for which voting rights have previously been approved. Fair value is determined without regard to the absence of voting rights for the control shares. If voting rights for control shares are approved at a shareholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other shareholders may exercise appraisal rights. The fair value of the shares as determined for purposes of these appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The control share acquisition statute does not apply to the following:

- shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction; or

- acquisitions approved or exempted by a provision in the charter or bylaws of the corporation adopted before the acquisition of shares.

Our bylaws contain a provision exempting any and all acquisitions by any person of our shares of capital stock from the control share acquisition statute. However, this provision may be amended or eliminated at any time in the future.

Anti-Takeover Effect of Maryland Law and of our Charter and Bylaws

The following provisions in our charter and bylaws and in Maryland law could delay or prevent a change in our control:

- the limitation on ownership and acquisition of more than 9.8% of our shares of capital stock;

- the ability of our board, without a shareholders' vote, to increase the aggregate number of authorized shares or the number of shares of any class or series and to issue additional shares, including additional classes of shares with rights defined at the time of issuance;

- the classification of our board into classes and the election of each class for three year staggered terms;

- the requirement of cause and a 75% vote of shareholders for removal of our directors;

- the provision that the number of our directors may be fixed only by vote of our board and that a vacancy on our board may be filled by a majority of our remaining directors;

- the advance notice requirements for shareholder nominations for directors and other proposals;

- the business combination provisions of Maryland law, if the applicable resolution of our board is rescinded or if our board's approval of a combination is not obtained; and

the provisions of the control share acquisition statute if the applicable bylaw provision is amended.

Rights Plan

In addition to the anti-takeover effect of Maryland law and of our charter and bylaws as noted above, we have adopted a rights plan which may have a similar effect.

On March 10, 2004, our board authorized a dividend distribution of one right for each of our outstanding common shares, to holders of record of our common shares at the close of business on April 10, 2004. Each right entitles the holder to buy one one thousandth of a junior participating preferred share (or in certain circumstances, to receive cash, property, common stock or our other securities) at an exercise price of $20 per one one thousandth of a junior participating preferred share. The preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption of the junior participating preferred shares are summarized above under "Description of capital stock-Junior participating preferred shares."

Initially, the rights are attached to common shares. The rights will separate from the common shares upon a rights distribution date which is the earlier of (1) 10 business days following a public announcement by us that a person or group of persons has acquired, or has obtained the right to acquire, beneficial ownership of 10% or more of the outstanding common shares or (2) 10 business days following the commencement of a tender offer or exchange offer that would result in a person acquiring beneficial ownership of 10% or more of the outstanding common shares. In each instance, our board may determine that the distribution date will be a date later than 10 days following the triggering event.

Until they become exercisable, the rights will be evidenced by the certificates for common shares and will be transferred with and only with such common share certificates. The surrender for transfer of any certificates for common shares outstanding will also constitute the transfer of the rights associated with the common shares evidenced by such certificates.

The rights are not exercisable until a rights distribution date and will expire at the close of business on April 10, 2014, unless earlier redeemed or exchanged by us as described below. Until a right is exercised, the holder thereof, as such, has no rights as a shareholder of us, including, without limitation, the right to vote or to receive dividends.

Upon the occurrence of a "flip-in event," each holder of a right will have the ability to exercise it for a number of common shares (or, in certain circumstances, other property) having a current market price equal to two times the exercise price of the right. Notwithstanding the foregoing, following the occurrence of a "flip-in event," all rights that are, or were, held by beneficial owners of 10% or more of our common stock will be void in several circumstances described in the rights agreement. Rights will not be exercisable following the occurrence of any "flip-in event" until the rights are no longer redeemable by us as set forth below. A "flip-in event" occurs when a person or group of persons acquires more than 10% of the beneficial ownership of the outstanding common shares pursuant to any transaction other than a tender or exchange offer for all outstanding common shares on terms which a majority of our outside directors determines to be fair to and otherwise in the best interests of us and our shareholders.

A "flip-over event" occurs when, at any time on or after the announcement of a share acquisition which will result in a person becoming the beneficial owner of more than 10% of our outstanding common shares, we take part in a merger or other business combination transaction (other than certain mergers that follow a fair offer) in which we are not the surviving entity or the common shares are changed or exchanged or 50% or more of our assets or earning power is sold or transferred. Upon the occurrence of a "flip-over event" each holder of a right (except rights which previously have been voided, as set forth above) will have the option to exchange their right for a number of shares of common stock of the acquiring company having a current market price equal to two times the exercise price of the right.

The purchase price and the number of junior participating preferred shares issuable upon exercise of the rights are subject to adjustment from time to time to prevent dilution. With certain exceptions, no adjustment in the purchase price will be required until cumulative adjustments amount to at least 1% of the purchase price. We will make a cash payment in lieu of any fractional shares resulting from the exercise of any right. We have 10 days from the date of an announcement of a share acquisition which will result in a person becoming the beneficial owner of more than 10% of our outstanding common shares to redeem the rights in whole, but not in part, at a price of $.01 per right, payable at our option in cash, common shares or other consideration as our board may determine. Immediately upon the effectiveness of the action of the board ordering redemption of the rights, the rights will terminate and the only right of the holders of rights will be to receive the redemption price.

The terms of the rights, other than key financial terms and the date on which the rights expire, may be amended by the board of directors prior to the distribution date. After the distribution date, the provisions of the rights agreement may be amended by the board only in order to:

- cure ambiguities, defects or inconsistencies;
- make changes which do not adversely affect the interests of holders of rights (other than the rights of a person that has obtained beneficial ownership of more than 10% of our outstanding shares and certain other related parties); or
- to shorten or lengthen any time period under the rights agreement.

However, no amendment to lengthen the time period governing redemption is permitted to be made at such time as the rights are not redeemable.

Underwriting

We and the underwriters for the offering named below have entered into an underwriting agreement concerning the shares being offered. Subject to conditions, each underwriter has severally agreed to purchase the number of shares indicated in the following table. are the representatives of the underwriters.

Underwriters	**Number of Shares**
Total	2,000,000

If the underwriters sell more shares than the total number set forth in the table above, the underwriters have a 30-day option to buy from us up to an additional 300,000 shares at the public offering price less the underwriting discounts and commissions to cover these sales. If any shares are purchased under this option, the underwriters will severally purchase shares in approximately the same proportion as set forth in the table above.

The following table shows the per share and total underwriting discounts and commissions we will pay to the underwriters. These amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase up to an additional 300,000 shares.

	No Exercise	Full Exercise
Per Share	$	$
Total		

We estimate that the total expenses of the offering payable by us, excluding underwriting discounts and commissions, will be approximately $450,000.

Shares sold by the underwriters to the public will initially be offered at the public offering price set forth on the cover of this prospectus. Any shares sold by the underwriters to securities dealers may be sold at a discount of up to $ per share from the public offering price. Any of these securities dealers may resell any shares purchased from the underwriters to other brokers or dealers at a discount of up to $ per share from the public offering price. If all the shares are not sold at the public offering price, the representatives may change the offering price and the other selling terms.

We and each of our officers, managing directors and Senior Housing have agreed with the underwriters not to offer, sell, contract to sell, hedge or otherwise dispose of, directly or indirectly, or file with the SEC a registration statement under the Securities Act of 1933 relating to, any shares of our common stock or securities convertible into or exchangeable for shares of our common stock during the period from the date of this prospectus continuing through the date 90 days after the date of this prospectus, without the prior written consent of , subject to limited exceptions.

In connection with this offering, the underwriters may purchase and sell shares of our common stock in the open market. These transactions may include stabilizing transactions, short sales and purchases to cover positions created by short sales. Stabilizing transactions consist of bids or purchases made for the purpose of preventing or retarding a decline in the market price of our common stock while the offering is in progress. These transactions may also include short sales and purchases to cover positions created by short sales. Short sales involve the sale by the underwriters of a greater number of shares than they are required to purchase in the offering. Short sales may be either "covered short sales" or "naked short sales." "Covered" short sales are sales made in an amount not greater than the underwriters' option to purchase additional shares from us in the offering. The underwriters may close out any covered short position by either exercising their option to purchase additional shares or purchasing shares in the open market. In determining the source of shares to close out the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. "Naked" short sales are any sales in excess of the over-allotment option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market after pricing that could adversely affect investors who purchase in the offering.

The underwriters also may impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the representatives have repurchased shares sold by or for the account of that underwriter in stabilizing or short covering transactions.

These activities by the underwriters may stabilize, maintain or otherwise affect the market price of our common stock. As a result, the price of our common stock may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. These transactions may be effected on the American Stock Exchange, in the over-the-counter market or otherwise.

We have agreed to indemnify the several underwriters against liabilities, including liabilities under the Securities Act and to contribute to payments that the underwriters may be required to make in respect thereof.

Some of the underwriters engage in transactions with us and our subsidiaries in the ordinary course of business.

Legal matters

Sullivan & Worcester LLP, Boston, Massachusetts, is counsel to us in connection with this offering. Venable LLP, Baltimore, Maryland, will issue an opinion about the legality of the shares we are offering. is counsel to the underwriters in connection with this offering. Barry M. Portnoy was a partner of the firm of Sullivan & Worcester LLP until March 1997, and is one of our managing directors, a managing trustee of Senior Housing and a director and 50% owner of RMR. Sullivan & Worcester LLP represents Senior Housing, RMR and certain of their affiliates on various matters.

Experts

The consolidated financial statements of Five Star Quality Care, Inc. at December 31, 2003 and 2002, and for each of the three years in the period ended December 31, 2003, appearing in this Prospectus and the Registration Statement have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

The consolidated financial statements of LTA Holdings, Inc. and Subsidiaries at December 31, 2003 and 2002, and for each of the three years in the period ended December 31, 2003, appearing in this Prospectus and the Registration Statement have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

Where you can find more information

We have filed with the SEC a registration statement on Form S-1 (including the exhibits, schedules and any amendments thereto) under the Securities Act of 1933 with respect to the shares being offered pursuant to this prospectus. This prospectus is part of this registration statement and does not contain all of the information set forth in the registration statement. Statements contained in this prospectus as to the content of any agreement or other document filed or incorporated by reference as an exhibit are not necessarily complete, and you should consult a copy of those contracts or other documents filed or incorporated by reference as exhibits to the registration statement. For further information regarding us, please read the registration statement and the exhibits and schedules thereto.

We are subject to the information and reporting requirements of the Securities Exchange Act of 1934 and, in accordance therewith, we file periodic reports, proxy statements and other information with the SEC.

You may read and copy the registration statement and its exhibits and schedules or other information on file at the SEC's Public Reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. You can request copies of those documents upon payment of a duplicating fee to the SEC. Information filed by us with the SEC can be copied at the SEC's Public Reference Room. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room. You can review our SEC filings and the registration statement by accessing the SEC's Internet site at http://www.sec.gov.

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FIVE STAR QUALITY CARE, INC.
UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET
At June 30, 2004
(amounts in thousands, except per share amounts)

	Five Star Historical	LTA Historical	Adjustments for the LTA Acquisition	Five Star Pro Forma	Adjustments for this Offering	Five Star Adjusted Pro Forma
		(A)			(G)	
ASSETS						
Current assets:						
Cash and cash equivalents	$ 28,879	$ 5,064	$ 116,000 **(B)**	$ 30,539	$ 13,135	$ 43,674
			(72,304)**(C)**			
			68,900 **(D)**			
			(116,000)**(E)**			
Accounts receivable, net	32,590	380		32,970		32,970
Prepaid expenses	3,476	2,941		6,417		6,417
Other current assets	3,449			3,449		3,449
Total current assets	68,394	8,385	(3,404)	73,375	13,135	86,510
Property, plant and equipment, net	40,526	153,590	55,792 **(C)**	72,598		72,598
			(12,310)**(F)**			
			(165,000)**(D)**			
Restricted cash, insurance arrangements	8,430			8,430		8,430
Restricted cash, other	21,334	1,709	(1,000)**(C)**	22,043		22,043
Mortgage note receivable	6,035			6,035		6,035
Goodwill		1,514	(1,514)**(C)**			
Investment in and advances to affiliates		215	(215)**(C)**			
Other long term assets	1,218	2,042	(2,042)**(C)**	1,218		1,218
Total assets	$ 145,937	$ 167,455	$ (129,693)	$ 183,699	$ 13,135	$ 196,834
LIABILITIES AND SHAREHOLDERS' EQUITY						
Current liabilities:						
Accounts payable	$ 10,885	$ 744	$	$ 11,629	$	$ 11,629
Accrued expenses	15,640	3,343		18,983		18,983
Accrued compensation and benefits	8,926	2,058		10,984		10,984
Due to Senior Housing Properties Trust	6,846		(116,000)**(B)**	6,846		6,846
			116,000 **(E)**			
Mortgages payable, current portion	48	2,280	(310)**(F)**	2,018		2,018
Accrued real estate taxes	4,825			4,825		4,825
Continuing care contracts	2,271			2,271		2,271
Other current liabilities	1,700			1,700		1,700
Total current liabilities	51,141	8,425	(310)	59,256		59,256
Long term liabilities:						
Mortgages payable	4,959	137,320	(12,000)**(F)**	34,179		34,179
			(96,100)**(D)**			
Continuing care contracts	10,392			10,392		10,392
Other long term liabilities	13,512	569	(142)**(C)**	13,939		13,939

	Five Star Historical	LTA Historical	Adjustments for the LTA Acquisition	Five Star Pro Forma	Adjustments for this Offering	Five Star Adjusted Pro Forma
Total long term liabilities	28,863	137,889	(108,242)	58,510		58,510
Total shareholders' equity	65,933	21,141	(21,141)**(C)**	65,933	13,135	79,068
Total liabilities and shareholders' equity	$ 145,937	$ 167,455	$ (129,693)	$ 183,699	$ 13,135	$ 196,834

See accompanying notes.

FIVE STAR QUALITY CARE, INC.
UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS
For the six months ended June 30, 2004
(amounts in thousands, except per share amounts)

	Five Star Historical	LTA Historical	Adjustments for the LTA Acquisition	Pro Forma	Adjustments for this Offering	Five Star Adjusted Pro Forma
		(H)			(M)	
Revenues:						
Revenues from residents	$ 298,362	$ 39,465	$	$ 337,827	$	$ 337,827
Pharmacy revenues	5,019			5,019		5,019
Interest and other income	1,664	30		1,694		1,694
	305,045	39,495		344,540		344,540
Expenses:						
Other operating expenses	241,230	27,117		268,347		268,347
Management fee to Sunrise Senior Living, Inc.	9,191			9,191		9,191
Rent expense	40,582		8,017 **(I)**	48,599		48,599
General and administrative	9,935	5,287	(1,683)**(J)**	13,539		13,539
Depreciation and amortization	1,839	2,935	(2,485)**(K)**	2,289		2,289
Interest expense	245	5,095	(3,941)**(L)**	1,399		1,399
Total expenses	303,022	40,434	(92)	343,364		343,364
Income (loss) from continuing operations before gain on sale of assets, equity in income of affiliates and income taxes	2,023	(939)	92	1,176		1,176
Gain on sale of assets		6		6		6
Equity in income of affiliates		27		27		27
		33		33		33
Income (loss) from continuing operations before income taxes	2,023	(906)	92	1,209		1,209
Provision for income taxes						
Income (loss) from contiuing operations	$ 2,023	$ (906)	$ 92	$ 1,209	$	$ 1,209
Weighted Average Shares Outstanding	8,520			8,520	2,000	10,520
Basic and diluted earnings per share from continuing operations	$ 0.24			$ 0.14		$ 0.12

See accompanying notes.

FIVE STAR QUALITY CARE, INC.
UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS
For the year ended December 31, 2003
(amounts in thousands, except per share amounts)

	Five Star Historical	LTA Historical (N)	Adjustments for the LTA Acquisition	Pro Forma	Adjustments for this Offering (S)	Five Star Adjusted Pro Forma
Revenues:						
Revenues from residents	$ 575,986	$ 75,365	$	$ 651,351	$	$ 651,351
Interest and other income	229	54		283		283
	576,215	75,419		651,634		651,634
Expenses:						
Other operating expenses	466,628	52,915		519,543		519,543
Management fee to Sunrise Senior Living, Inc.	17,391			17,391		17,391
Rent expense	77,266		16,033 **(O)**	93,299		93,299
General and administrative	17,745	8,679	(3,394)**(P)**	23,030		23,030
Depreciation and amortization	3,588	6,092	(5,193)**(Q)**	4,487		4,487
Loss from early extinguishment of debt		366		366		366
Interest expense	1,164	10,558	(8,250)**(R)**	3,472		3,472
Impairment of long lived assets		38		38		38
Total expenses	583,782	78,648	(804)	661,626		661,626
Income (loss) from continuing operations before gain on sale of assets, minority interest in income of consolidated entity, equity in income of affiliates and income taxes	(7,567)	(3,229)	(804)	(9,992)		(9,992)
Gain on sale of assets		1,529		1,529		1,529
Minority interest in income of consolidated entity		(57)		(57)		(57)
Equity in income of affiliates		72		72		72
		1,544		1,544		1,544
Income (loss) from continuing operations before income taxes	(7,567)	(1,685)	(804)	(8,448)		(8,448)
Provision for income taxes						
Loss from contiuing operations	$ (7,567)	$ (1,685)	$ (804)	$ (8,448)	$	$ (8,448)
Weighted average shares outstanding	8,482			8,482	2,000	10,482
Basic and diluted earnings per share from continuing operations	$ (0.89)			$ (1.00)		$ (0.81)

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

NOTES TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands, except share and per share amounts)

INTRODUCTION TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

The unaudited pro forma consolidated balance sheet at June 30, 2004, presents the financial position of Five Star Quality Care, Inc., as if our acquisition of LTA Holdings, Inc. ("LTA"), our sale-lease back transaction of 35 communities with Senior Housing Properties Trust ("Senior Housing") and the offering had been completed as of June 30, 2004, as described in the notes thereto. The unaudited pro forma consolidated statements of operations for the six months ended June 30, 2004 and for the year ended December 31, 2003, present the results of operations of Five Star as if our acquisition of LTA, the related sale-leaseback transaction of 35 communities with Senior Housing and the offering had been completed as of the beginning of the periods presented, as described in the notes thereto.

These unaudited pro forma consolidated financial statements do not represent our financial condition or results of operations for any future date or period. Actual future results may be materially different from pro forma results. Differences could arise from many factors, including, but not limited to those set forth under "Risk factors" and "Warning concerning forward looking statements" such as, competition in our business, the impact of changes to rates under Medicare and Medicaid reimbursement programs, our ability to successfully attract residents to our facilities, our ability to control operating expenses and our capital structure and other changes. These unaudited pro forma consolidated financial statements should be read in conjunction with our consolidated financial statements and the related management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2003 (audited) and the six months ended June 30, 2004 (unaudited), the audited consolidated financial statements of LTA for the year ended December 31, 2003 and the unaudited consolidated financial statements of LTA for the six months ended June 30, 2004, all of which are included elsewhere in this prospectus.

Pro Forma Consolidated Balance Sheet Adjustments

A.
Represents the historical consolidated balance sheet of LTA as of June 30, 2004.

B.
Under the terms of an agreement with Senior Housing, Senior Housing will loan us $116,000, which we will use to fund a portion of the purchase price for LTA. Our agreement with Senior Housing also requires us to enter into a sale-leaseback transaction whereby we will sell to Senior Housing 35 of the communities that we will acquire from LTA and lease these properties from Senior Housing. We will use the net proceeds from the sale-leaseback transaction to repay the $116,000 interim financing provided to us by Senior Housing. This adjustment represents our entering into the loan with Senior Housing and the proceeds that we receive from that loan.

C.
Represents the elimination of the historical equity balances of LTA as well as the adjustments to preliminarily allocate purchase price to the fair value of the assets we will acquire and the liabilities we will assume. The LTA acquisition will be accounted for using the purchase method of accounting and the purchase price will be allocated to the assets acquired and liabilities assumed based on their estimated fair values. The initial purchase price is estimated to be $211,904 including transaction costs of approximately $1,000 and is comprised of cash of $72,304 and debt assumed of $139,600. The initial purchase price has been allocated to assets acquired and liabilities assumed based on current estimates of working capital and valuations of assets and liabilities. The working capital amounts are subject to certain contractual true-up provisions subsequent to closing.

Additionally, certain valuations are subject to adjustment as additional information on certain estimates becomes available. The following table summarizes the preliminary estimates of fair values of the assets we will acquire and the liabilities we will assume in the LTA acquisition:

Net current assets	$	2,904
Property, plant and equipment		209,000
Total assets to be acquired		211,904
Current debt		2,280
Long term debt		137,320
Total liabilities to be assumed		139,600
Net assets acquired	$	72,304

D.

As described in Note B, subsequent to our acquisition of LTA, we and Senior Housing have agreed to enter into a sale-leaseback transaction with Senior Housing whereby Senior Housing will purchase from us 35 of the communities that we will acquire from LTA. The negotiated purchase price of this sale-leaseback transaction is $165,000, which represents the fair market value of the 35 communities. Senior Housing will fund the acquisition of the 35 properties from us by assuming the existing debt of $96,100 on certain of the 35 communities and pay the remaining $68,900 of the purchase price in cash. The adjustment reflects this sale-leaseback transaction.

E.

As described in Note B, we intend to use the net proceeds from our sale-leaseback transaction with Senior Housing to repay in its entirety the interim financing that Senior Housing will extend to us in connection with the closing of the LTA acquisition. The adjustment reflects this loan repayment to Senior Housing.

F.

Prior to our closing of the LTA acquisition, LTA will have renegotiated a lease with Health Care Properties Investors, Inc., or HCPI, for four properties. As of June 30, 2004, this lease was structured as a capital lease, but as part of the renegotiation, this amended lease will be structured so that it will be an operating lease under generally accepted accounting principles. The adjustment represents the elimination of the capitalized real estate lease and the associated short and long term capital lease obligation.

G.

Represents our issuance of 2 million common shares in this offering as follows:

Gross proceeds from the issuance of 2,000,000 common shares at an assumed public offering price of $7.10 per share	$	14,200
Underwriters' discount and other offering costs, estimated		1,065
Net proceeds	$	13,135

Pro Forma Consolidated Statement of Operations for the six months ended June 30, 2004 Adjustments

H.

Represents the historical consolidated statement of operations of LTA for the six months ended June 30, 2004.

I.

Our lease with Senior Housing for the 35 properties subject to the sale-leaseback transaction will require us to make minimum rent payments of $14,850 per year, or $7,425 for the six month period. In addition to minimum rent under this lease, beginning in 2006 we will be required to pay percentage rent payments equal to four percent (4%) of net resident revenues at all of the leased communities in excess of net resident revenues at such communities during 2005. Adjustment also includes rental expense in connection with the HCPI lease for four properties (See Note F). The adjustment is calculated as follows:

Rental expense to Senior Housing	$	7,425
Rental expense to HCPI		592
Total adjustment	$	8,017

J.

Represents the elimination of historically incurred general and administrative expenses of LTA comprising compensation and related expenses of LTA officers and other employees who we will not employ and rent for a corporate office lease that we will terminate, net of our additional costs under our shared services agreement with Senior Housing. The identified employees and the lease with the corporate office will be terminated by LTA prior to our acquisition. The adjustment is calculated as follows:

Elimination of seller's general and administrative expenses		$	(1,920)
Shared services fee:			
Pro forma revenues	39,465		
Contract rate	0.6%		237
Total adjustment		$	(1,683)

K.

Represents the elimination of historical depreciation and amortization expense related to LTA. This amount is offset by depreciation that we will incur as a result of the eight communities that we will acquire which are not subject to the sale-leaseback transaction with Senior Housing. The adjustment is calculated as follows:

Elimination of historical amounts	$	(2,935)
Our depreciation of the cost of the acquired buildings (estimated to be $26,921) using a 40 year life		337
Our depreciation of the cost of the acquired furniture and other fixed assets (estimated to be $1,584) using a seven year life		113
Total adjustment	$	(2,485)