

Explanation of the New Sunwest Business Structure

Choice of REIT as basic structure. One of the most important aims of the new Sunwest business structure is to provide liquidity to its claimant-owners. A significant number of investors relied on monthly payments from Sunwest as a key source of income, and many of these individuals remain sorely pressed for cash. The company's financial situation limits the amount of cash available for distribution to investors. In the search for other ways to provide liquidity, the CRO and Receiver settled on a REIT structure as the best option. REITs are required to distribute 90% of their income annually, ensuring that distributions of cash will resume as soon as possible. It is anticipated that the REIT will be a publicly reporting company and that it may participate in a merger, public offering, or other transaction at some point in the future. That event, whatever form it takes, is intended to provide significant value and liquidity to investors. In the meantime, investors who need cash may be able to find other claimants who want to purchase their shares.

The CRO and Receiver team also considered creating a C-corporation. A C-corp would have provided the desired liquidity, as well as a much simpler business structure. On the other hand, C-corps are taxed at both the corporate and the shareholder levels, while REITs are generally pass-through structures where income is not taxed until it reaches the owners. Because of its tax status, the REIT will deliver significantly more return to its owners. At the same time, the tax advantages come with a set of requirements that complicate the corporate picture. Key REIT rules require:

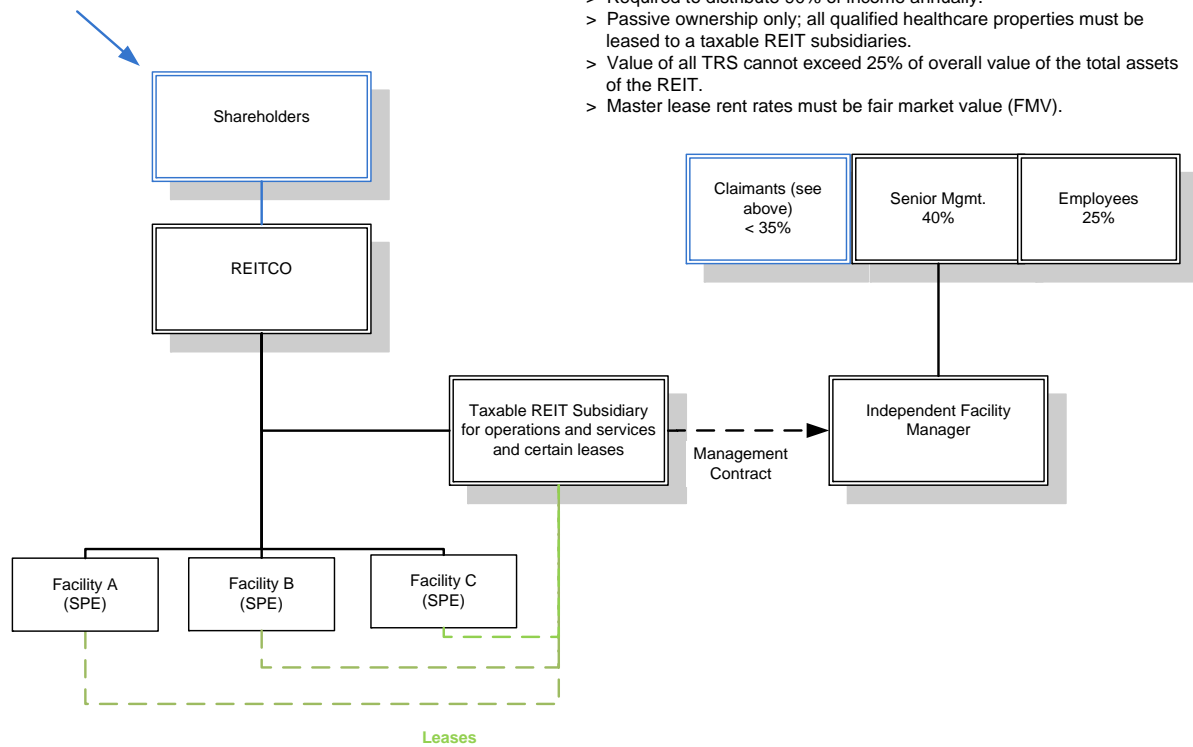
- Passive income only (e.g., through rents received from property ownership). This rule means that while REITs can collect rents they cannot conduct business operations. However, REITs can form wholly-owned entities called "taxable REIT subsidiaries" (TRS) for operational purposes. The set-up allows the value of operations to remain in the REIT for the benefit of its owners. The Sunwest REIT will form a TRS to provide operations and services to properties where needed, through master leases between the TRS and individual properties. Separate TRS's may also be formed for insurance and equipment leasing.
- Certain kinds of healthcare facilities owned by REITs (including assisted living facilities) have to be managed by an independent contractor to the TRS.
- A maximum of 35% commonality between shareholders of the REIT and ownership of the independent management company. This is why the remaining management company ownership proposed in the CRO/Receiver's plan is held by senior management and employees.¹
- Annual distribution to shareholders of 90% of the REIT's taxable income.
- The value of all TRS's owned by the REIT may not exceed 25% of the REIT's overall value.
- Master lease rents must be at fair market values.

By itself, the REIT structure would look like this:

¹ It is not contemplated that any of the original Sunwest principals (Harder, Fisher, Gutzler) will belong to this management-owner group.

Sunwest REIT Structure with no special options

All claimants exchange existing claims or interests for securities and go into REIT in a taxable transaction.



KEY REIT RULES

- > Maximum of 35% common ownership of REIT and Management Company. (Subject to certain circumstances, the structure may be revised to provide that the TRS rather than the Claimants holds this part of the ownership.)
- > Required to distribute 90% of income annually.
- > Passive ownership only; all qualified healthcare properties must be leased to a taxable REIT subsidiaries.
- > Value of all TRS cannot exceed 25% of overall value of the total assets of the REIT.
- > Master lease rent rates must be fair market value (FMV).

Both the REIT/MLP and the management company will be governed by professional boards consisting of experts in appropriate areas such as finance, accounting, management, REITs, and healthcare. The initial REIT board will consist of at least two transitional members familiar with Sunwest and its recent history. Two directors from the REIT board will also serve on the board of the management company.

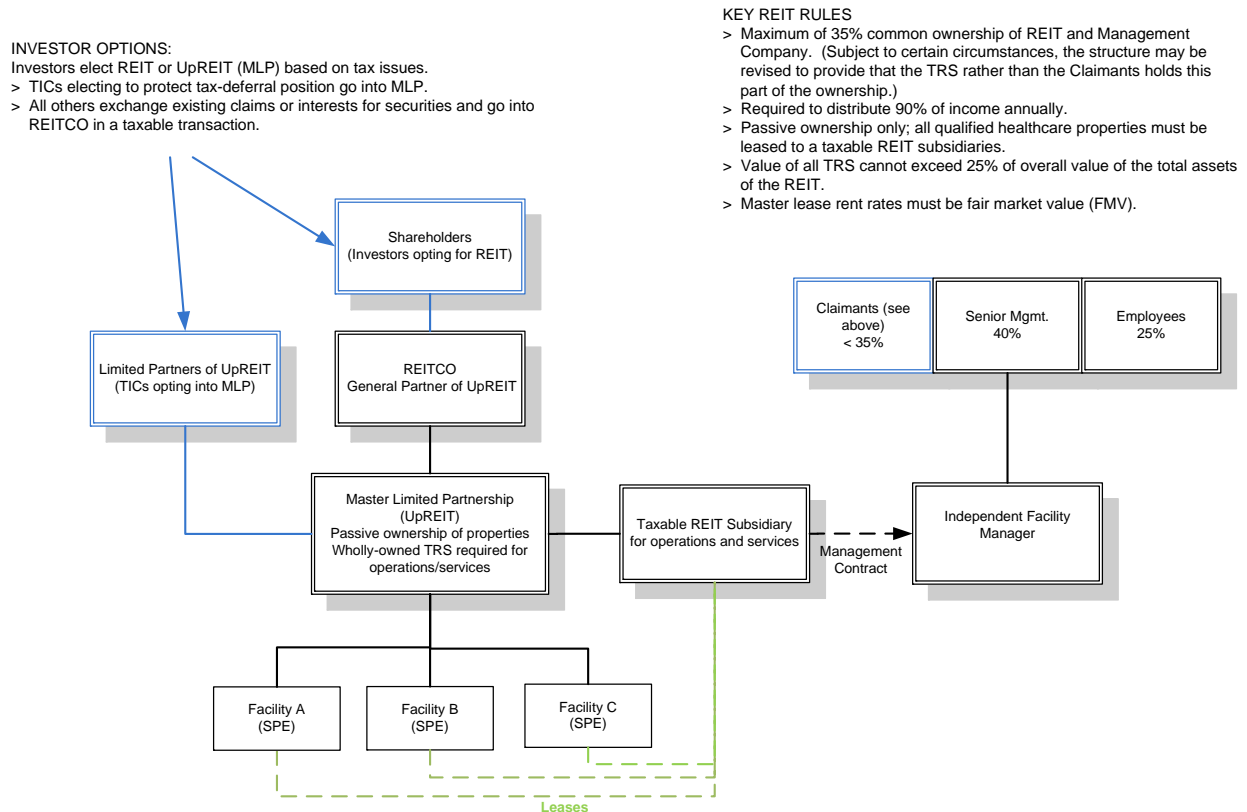
Master Limited Partnership structure. A disadvantage of the REIT for some investors (and an advantage for others) is the fact that the transaction in which allowed claims are exchanged for REIT shares is taxable. For this reason, the CRO and Receiver also considered using a master limited partnership (MLP) instead of a REIT as the basic form of the new enterprise. Like the REIT, an MLP provides a pass-through tax structure, but it also enables investors under certain circumstances to transfer in without experiencing a taxable event. The problem with the MLP is lack of liquidity due to severe restrictions imposed on the transfer of partnership interests.

In an effort to get the best of both worlds, the CRO/Receiver team decided to layer an MLP structure (also called an "UPREIT") into the REIT. Investors can elect to go into the UPREIT, or with no election go into the REIT. TICs who need to continue deferring taxes may opt for the MLP, while others (including TICs who have already lost their interests to foreclosure, TICs who want to take their tax gains or losses now, or unsecured creditors who don't have the same tax considerations) will go straight into the REIT.

So long as investors remain in the MLP their interests have limited transferability, but subject to certain restrictions they can exchange for REIT shares at any time to get the advantage of liquidity.

With the addition of the MLP, the REIT structure now looks like this:

Sunwest REIT Structure with MLP tax-deferral option



Addition of right to retain property interests. The structure depicted above provides investors with the option of continued tax-deferral, but it does not allow for the retention of any pre-existing property interests. Because this issue is so important to many investors (both TICs and LLC members), a further layer was added to the overall structure with the creation of “DownREITs.” These are sub-partnerships of the MLP, which enable the MLP to co-own a property with other partners; the MLP is the general partner of the DownREIT, whose limited partners will be LLC members electing to retain their property interests. TICs who retain their property interests remain outside the REIT/MLP structure entirely; they will be co-tenants in their properties with the MLP, subject to master leases and tenant in common agreements. Both property-retention options are shown below in the final organizational drawing of the proposed new entity:

Sunwest REIT Structure with options for tax deferral and property interest retention

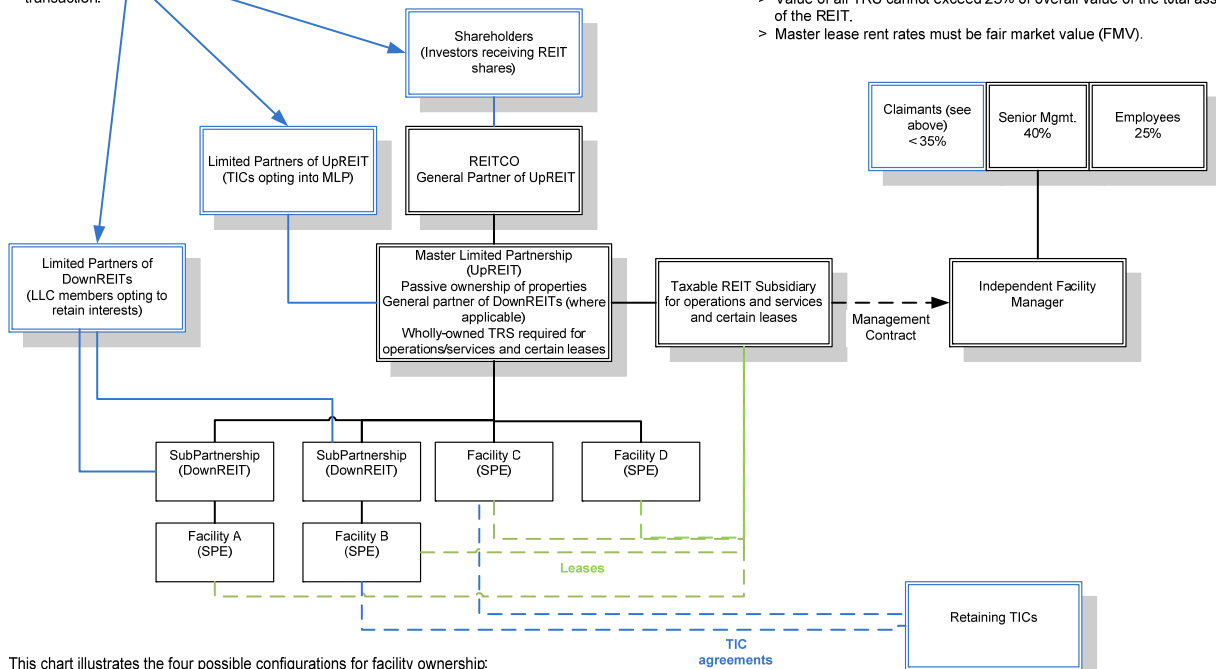
INVESTOR OPTIONS:

Investors elect REIT, UpREIT (MLP), or DownREIT based on tax issues and whether they want to retain property interests.

- > TICs electing to preserve tax-deferral status go into the MLP.
- > LLC members electing to retain property interests go into property-specific DownREITs.
- > TICs wishing to retain bare legal title remain outside the structure (1031 status will not be preserved).
- > All others exchange existing claims or interests for securities and go into REITCO in a taxable transaction.

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- > Required to distribute 90% of income annually.
- > Passive ownership only; all qualified healthcare properties must be leased to a taxable REIT subsidiaries.
- > Value of all TRS cannot exceed 25% of overall value of the total assets of the REIT.
- > Master lease rent rates must be fair market value (FMV).



This chart illustrates the four possible configurations for facility ownership:

- Facility A. Owned by MLP and retaining LLC members.
- Facility B. Owned by MLP, retaining LLC members, and retaining TICs.
- Facility C. Owned by MLP and retaining TICs.
- Facility D. Owned by MLP only.

Summary of investor options. In the end, investors can make the following elections:

- TICs who still have property interests may elect to:
 - Convey their property interests to the MLP in a tax-deferred transaction; or
 - Remain outside the REIT/MLP structure and retain bare legal title, subject to revised lease terms as specified in the plan. (This option does NOT preserve 1031 or other tax-deferral status.)
 - Absent one of these elections, the property interests of the TICs will be conveyed to the REIT.
- LLC members may elect to:
 - Retain membership interests subject to revised terms as specified in the Plan.
 - Absent such an election, their membership interests will be conveyed to the REIT in a taxable transaction.
- All other investors, including those who have already lost their property interests (e.g., through foreclosure or short sale), will become shareholders in the REIT on the basis of their Allowed Claims.