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PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Financial Statements

December 31, 2005 and 2004

(With Independent Auditor's Report Thereon)

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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RETIREMENT AND SENIOR
CARE SERVICES

1217 Slate Hill Road • Camp Hill, Pennsylvania 17011

Certification of Chief Executive and Chief Financial Officers

We are responsible for the financial statements and supporting information of Presbyterian Senior Living Services, Inc., as of December 31, 2005 and 2004, and attest that they are accurate, complete and fairly presented.

The accuracy and completeness of financial information depends on our systems, process, and most importantly our integrity. Our commitment to integrity is reflected in the code of conduct that the leadership of PHI has established as the standard for the entire organization. We believe that this commitment, our processes and internal controls produce financial information that can be trusted.

Financial statements report our financial position and results using numbers and prescribed rules. They also include a significant amount of information that is required by financial reporting standards. We believe these financial statements disclose information that is important to create a complete picture of our stewardship of financial resources.

Financial statements alone can never reflect the breadth and depth of our stewardship of this ministry. They do not report on our most significant assets, our employees and volunteers. They also do not reflect our most important stewardship role; our commitment to provide Christian understanding and compassion to those seniors entrusted to our care. We believe that we continue to successfully fulfill the financial and non-financial aspects of our mission, extending a proud tradition of ministry that has served older persons in the name of Christ for the past 78 years.

Finally, we believe in openly and honestly sharing information. Please feel free to contact either of us if you have questions on any part of this report, or if we can be of further assistance in understanding PHI's mission.

Steve Proctor

Stephen E. Proctor
Chief Executive Officer
PHI

Jeffrey J. Davis

Jeffrey J. Davis
Chief Financial Officer
PHI

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Presbyterian Homes, Inc. • Presbyterian Housing & Services Corporation • Presbyterian Senior Living Services, Inc.
Presbyterian Apartments, Inc. • Geneva House, Inc. • Presbyterian Homes in the Presbytery of Huntingdon

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bmc

Independent Auditor's Report

The Board of Directors
Presbyterian Senior Living Services, Inc.:

We have audited the accompanying consolidated statements of financial position of Presbyterian Senior Living Services, Inc. (an affiliate of PHI) as of December 31, 2005 and 2004, and the related consolidated statements of activities and changes in net assets (liabilities), and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Presbyterian Senior Living Services, Inc. as of December 31, 2005 and 2004, and the changes in their net assets (liabilities), and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, PA
February 25, 2006

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Financial Position

December 31, 2005 and 2004

Assets		**2005**	**2004**
Current assets:			
Cash and cash equivalents	$	231,635	15,959
Investments		167,691	181,141
Accounts receivable, net		534,842	424,653
Current portion, assets whose use is limited		542,104	492,819
Prepaid expenses and other current assets		167,734	146,912
Total current assets		1,644,006	1,261,484
Assets whose use is limited, net of current portion		1,399,367	1,275,312
Property and equipment (net of accumulated depreciation of $14,510,774 and $13,139,797, respectively)		32,736,907	33,274,054
Other assets:			
Deferred financing costs (net of accumulated amortization of $102,344 and $86,115, respectively)		362,326	378,555
Total assets	$	36,142,606	36,189,405

See accompanying notes to consolidated financial statements.

(Continued)

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Financial Position

December 31, 2005 and 2004

Liabilities and Net Liabilities	**2005**	**2004**
Current liabilities:		
Accounts payable	$ 942,789	1,319,548
Accrued expenses	338,943	458,705
Note payable	676,000	387,000
Current portion:		
Annuities payable	17,975	17,975
Bonds payable	330,000	305,000
Total current liabilities	2,305,707	2,488,228
Deferred revenue – entrance fees	19,346,596	19,686,221
Resident deposits	112,940	237,830
Due to affiliated entity	4,637,867	3,181,678
Fair value of interest rate swaps	—	183,745
Annuities payable, net of current portion	67,230	73,407
Bonds payable, net of current portion	18,750,000	19,080,000
Total liabilities	45,220,340	44,931,109
Net (liabilities) assets:		
Unrestricted	(9,501,193)	(9,123,411)
Temporarily restricted	87,609	45,857
Permanently restricted	335,850	335,850
Total net liabilities	(9,077,734)	(8,741,704)
Total liabilities and net liabilities	$ 36,142,606	36,189,405

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Activities and Changes in Net Assets (Liabilities)

Year ended December 31, 2005

(with comparative December 31, 2004 totals)

	2005				
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**2004 Total**
Revenues, gains and other support:					
Resident services, including amortization of entrance fees of $1,249,326 and $1,140,779, respectively	$ 10,369,931	—	—	10,369,931	10,151,535
Interest and dividend income	52,648	12,146	—	64,794	43,811
Realized gains on marketable securities	7,430	—	—	7,430	354
Contributions	—	30,693	—	30,693	74,478
Net assets released from restrictions	28,547	(28,547)	—	—	—
Total revenues, gains and other support	10,458,556	14,292	—	10,472,848	10,270,178
Expenses:					
Nursing services	1,975,760	—	—	1,975,760	2,041,129
Rehabilitation	199,345	—	—	199,345	160,613
Recreation and special services	272,858	—	—	272,858	262,972
Pharmacy	88,257	—	—	88,257	62,655
Social services	13,205	—	—	13,205	1,367
Physician services	28,399	—	—	28,399	27,362
Food services	1,562,918	—	—	1,562,918	1,502,091
Building operations and maintenance	1,719,766	—	—	1,719,766	1,586,970
Housekeeping	357,678	—	—	357,678	337,709
Laundry and linen	38,325	—	—	38,325	37,022
General and administrative	1,662,807	—	—	1,662,807	1,715,981
Employee benefits	520,954	—	—	520,954	442,227
Interest	1,141,049	—	—	1,141,049	903,843
Depreciation	1,370,977	—	—	1,370,977	1,349,507
Amortization	16,229	—	—	16,229	16,229
Change in fair value of interest rate swaps	(183,745)	—	—	(183,745)	(333,759)
Total expenses	10,784,782	—	—	10,784,782	10,113,918
Change in net assets (liabilities) before unrealized (losses) gains on marketable securities	(326,226)	14,292	—	(311,934)	156,260
Unrealized (losses) gains on marketable securities	(51,556)	27,460	—	(24,096)	17,734
Change in net assets (liabilities)	(377,782)	41,752	—	(336,030)	173,994
Net assets (liabilities), beginning of year	(9,123,411)	45,857	335,850	(8,741,704)	(8,915,698)
Net assets (liabilities), end of year	$ (9,501,193)	87,609	335,850	(9,077,734)	(8,741,704)

See accompanying notes to consolidated financial statements

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Activities and Changes in Net Assets (Liabilities)

Year ended December 31, 2004

	2004			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Revenues, gains and other support:				
Resident services, including amortization of entrance fees of $1,140,779	$ 10,151,535	—	—	10,151,535
Interest and dividend income	30,840	12,971	—	43,811
Realized gains on marketable securities	354	—	—	354
Contributions	15,099	59,324	55	74,478
Net assets released from restrictions	90,408	(90,408)	—	—
Total revenues, gains and other support	10,288,236	(18,113)	55	10,270,178
Expenses:				
Nursing services	2,041,129	—	—	2,041,129
Rehabilitation	160,613	—	—	160,613
Recreation and special services	262,972	—	—	262,972
Pharmacy	62,655	—	—	62,655
Social services	1,367	—	—	1,367
Physician services	27,362	—	—	27,362
Food services	1,502,091	—	—	1,502,091
Building operations and maintenance	1,586,970	—	—	1,586,970
Housekeeping	337,709	—	—	337,709
Laundry and linen	37,022	—	—	37,022
General and administrative	1,715,981	—	—	1,715,981
Employee benefits	442,227	—	—	442,227
Interest	903,843	—	—	903,843
Depreciation	1,349,507	—	—	1,349,507
Amortization	16,229	—	—	16,229
Change in fair value of interest rate swaps	(333,759)	—	—	(333,759)
Total expenses	10,113,918	—	—	10,113,918
Change in net assets (liabilities) before unrealized gains on marketable securities	174,318	(18,113)	55	156,260
Unrealized gains on marketable securities	17,734	—	—	17,734
Change in net assets (liabilities)	192,052	(18,113)	55	173,994
Net assets (liabilities), beginning of year	(9,315,463)	63,970	335,795	(8,915,698)
Net assets (liabilities), end of year	$ (9,123,411)	45,857	335,850	(8,741,704)

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Change in net liabilities	$ (336,030)	173,994
Adjustments to reconcile change in net liabilities to net cash provided by operating activities:		
Depreciation	1,370,977	1,349,507
Proceeds from entrance fees and deposits	5,117,040	5,455,162
Amortization of entrance fees	(1,249,326)	(1,140,779)
Change in fair value of interest rate swaps	(183,745)	(333,759)
Unrealized losses (gains) on marketable securities	24,096	(17,734)
Realized gains on marketable securities	(7,430)	(354)
Contributions restricted for long-term purposes	—	(55)
Amortization	16,229	16,229
Change in assets and liabilities:		
Accounts receivable	(110,189)	(108,362)
Prepaid expenses and other current assets	(20,821)	37,927
Accounts payable	(376,759)	644,782
Other current liabilities	(119,762)	89,728
Swap termination fee payable	—	(1,795,000)
Net cash provided by operating activities	4,124,280	4,371,286
Cash flows from investing activities:		
Acquisition of property and equipment	(833,830)	(1,027,965)
Purchases of investments	(1,239,282)	(1,050,538)
Proceeds from sale of investments	1,250,973	992,852
Change in assets whose use is limited	(188,248)	(254,364)
Net cash used in investing activities	(1,010,387)	(1,340,015)
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(4,332,229)	(4,888,536)
Principal payments and redemptions of bonds	(305,000)	(280,000)
Proceeds from (payments on) note payable	289,000	(115,000)
Contributions restricted for long-term purposes	—	55
Change in annuities payable	(6,177)	24,648
Change in due to affiliates	1,456,189	2,226,425
Net cash used in financing activities	(2,898,217)	(3,032,408)
Net increase (decrease) in cash and cash equivalents	215,676	(1,137)
Cash and cash equivalents, beginning of year	15,959	17,096
Cash and cash equivalents, end of year	$ 231,635	15,959

See accompanying notes to consolidated financial statements.

(1) General Information

Presbyterian Senior Living Services, Inc. (the Corporation) is a not-for-profit corporation, which operates Glen Meadows Retirement Community, a Continuing Care Retirement Community (the Community) located in Glen Arm, Maryland, which provides housing, health care, and other related services to the elderly. The Corporation is also the parent company to a fully controlled affiliate Glen Meadows Retirement Community, Inc. (GMRCI). The Glen Meadows Foundation (the Foundation) was established for the exclusive benefit of the Community and certain assets held by the Corporation are designated for the Foundation. The consolidated financial statements of the Corporation include the financial position and activities of GMRCI and the Foundation. The Corporation and Foundation are governed by independent Boards of Directors, who are elected by the Board of Trustees of PHI, the Corporation's parent organization, the residents of Glen Meadows and the Presbytery of Baltimore.

The Community contains 114 independent living cottages, 98 independent living apartments, 29 assisted living units and a 31-bed skilled nursing facility. The facility covers approximately 60 acres of the 483-acre site owned by the Corporation.

The Corporation was formed on July 1, 1999 whereby all operations of Presbyterian Senior Services, Inc. (PSSI) were transferred to Presbyterian Senior Living Services, Inc. and Glen Meadows Retirement Community, Inc. PSSI's corporate existence was discontinued. Under this new structure, the property, plant and certain equipment of PSSI was transferred to Glen Meadows Retirement Community, Inc., and the operations, other assets, and all liabilities of PSSI were transferred to Presbyterian Senior Living Services, Inc. Presbyterian Senior Living Services, Inc. is a fully controlled subsidiary of PHI, a management company located in Camp Hill, Pennsylvania.

(2) Summary of Significant Accounting Policies

(a) Basis of Consolidation

These consolidated financial statements have been prepared to focus on Presbyterian Senior Living Services, Inc. as a whole. All material intercompany transactions have been eliminated.

(b) Basis of Accounting

These consolidated financial statements, which are presented on the accrual basis of accounting, have been prepared to focus on the Corporation as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions.

(continued)

(b) Basis of Accounting (continued)

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law.

(c) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. The Corporation's temporarily restricted net assets consist principally of funds directed for special projects and resident welfare. Net assets released from restriction consist of expenses incurred satisfying those restricted purposes. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. Permanently restricted net assets are primarily restricted for resident welfare.

(d) Donor Restrictions

The Corporation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose to which the donation is restricted is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities and changes in net assets (liabilities) as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying consolidated financial statements.

The Corporation reports non-cash gifts as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Corporation reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

(e) Cash and Cash Equivalents

The Corporation considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents, for the purposes of the statements of financial position and cash flows, except for those included in investments or assets whose use is limited. At times during the years ended December 31, 2005 and 2004, cash balances may have exceeded the federally insured limit of $100,000.

(continued)

(f) ***Consolidated Statements of Cash Flows***

Interest paid during the years ended December 31, 2005 and 2004 was $1,134,803 and $828,953, respectively.

(g) ***Accounts Receivable***

Accounts receivable are shown net of an estimated allowance for doubtful accounts, as follows:

		2005	2004
Total accounts receivable	$	569,744	476,158
Less: allowance for doubtful accounts		(34,902)	(51,505)
Net accounts receivable	$	534,842	424,653

The allowance for doubtful accounts is established based on management's assessment of the collectibility of specific customer accounts and the aging of the accounts receivable.

(h) ***Deferred Financing Costs***

The Corporation has deferred the costs incurred for obtaining the proceeds of the Corporation's bonds payable. These costs are being amortized over the life of the related bond using the straight-line method, which approximates the effective interest method.

(i) ***Property and Equipment***

Property and equipment are stated at cost or, if donated, at fair market value on the date of donation. Depreciation is being provided on the straight-line method over the estimated useful lives of the assets. The Corporation's policy is to capitalize items in excess of $2,000 or for a group of items totaling $2,000 or more.

Depreciable lives are determined as follows:

Land improvements	15-25 years
Buildings and improvements	10-25 years
Departmental equipment, furniture and fixtures	10-25 years
Vehicles	5 years

(continued)

(j) Investments

Investments in marketable equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position. A decline in market value of any investment below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to realized loss and a new cost basis for the investment is established. For the years ended December 31, 2005 and 2004, no amounts were charged to realized loss.

Investment income consisted of the following:

		2005	**2004**
Interest and dividends	$	64,794	43,811
Realized gains on investments		7,430	354
Unrealized (losses) gains on marketable securities		(24,096)	17,734
	$	48,128	61,899

Investment expenses of $5,151 and $4,971 as of December 31, 2005 and 2004, respectively have been included in general and administrative expenses.

(k) Assets Whose Use is Limited

Assets whose use is limited are measured at fair value in the statements of financial position and include money deposited with a trustee under a debt agreement, assets restricted by donors for capital improvements, and the Maryland Department of Aging Operating Reserve.

(l) Deferred Revenue – Entrance Fees

Residents entering the Community execute a Residence and Care Agreement, which requires payment of an entrance fee, based on the unit to be occupied. Ten percent of the entrance fee, as approved by the Maryland Department of Aging, is due upon execution of the agreement and the remainder is due upon occupancy. Entrance fees are refundable in full upon termination of the agreement and subsequent reoccupancy of the unit. These entrance fees are amortized into revenue using the straight-line method over the remaining useful life of the facility. In November 2003, the Maryland Department of Aging approved for single residents both 25% nonrefundable and 50% nonrefundable entrance fee contracts. In January 2004, the Maryland Department of Aging approved both 25% nonrefundable and 50% nonrefundable entrance fee contracts to married couples. The Community adopted these contracts for both single and married residents in 2004 in addition to continued use of the 100% refundable contract.

The amount of entrance fees refundable to residents at December 31, 2005 and 2004 under contractual refund provisions was approximately $28,448,000 and $28,400,000, respectively.

(continued)

(m) Resident Deposits

Entrance fees and waiting list deposits received from prospective residents prior to occupancy under Residence and Care Agreements are included in resident deposits in the consolidated statements of financial position. These deposits are transferred to deferred revenue upon occupancy of the related units.

(n) Resident Services Revenue and Business Concentration

Resident services revenue is reported at the estimated net realizable amount to be received from patients and others including Medicare, Maryland Medicaid (Medicaid), and other third-party payors for services rendered. The Corporation derives a significant portion of its revenues from federal and state reimbursement programs. These reimbursements are subject to audit and retroactive adjustment in future periods. The Community is certified to receive benefits under Medicare and Medicaid.

The reimbursement methodology for a variety of health care providers has changed significantly as a result of provisions contained in the Balanced Budget Act of 1997 ("Budget Act"). The Budget Act provides for a prospective payment system ("PPS") for Medicare reimbursement for skilled nursing services (rather than the retrospective cost-based methodology in place prior to July 1, 1998). Skilled nursing facilities are paid a federal per diem rate for covered services, which include routine and ancillary services and most capital-related costs. In conjunction with PPS, consolidated billing for Medicare Part A Services is required for skilled nursing facilities. Under consolidated billing for Medicare Part A Services, facilities must bill Medicare for all of the services residents receive, including all therapy services.

Nursing services provided to Medicaid beneficiaries are cost-reimbursed to the extent of established ceiling limits. These rates vary according to a resident classification system that is based on clinical diagnosis and other factors. The Corporation's existence in Maryland exposes it to the risk of changes in Medicaid reimbursement in this state.

Revenues from Medicare and Medicaid represent approximately 12% of consolidated revenues for 2005 and 2004. Medicare and Medicaid receivables represent approximately 53% and 60% of consolidated accounts receivable at December 31, 2005 and 2004, respectively.

(continued)

(o) Use of Estimates

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

(p) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2005 and 2004, was $59,833 and $64,253, respectively.

(q) Classification of Expenses

		2005	2004
Program activities	$	9,305,720	8,731,696
General and administrative		1,639,481	1,687,932
Change in fair value of interest rate swaps		(183,745)	(333,759)
Fundraising		23,326	28,049
	$	10,784,782	10,113,918

(r) Tax Status

The Corporation and its subsidiaries are tax exempt under Section 501(c)(3) of the Internal Revenue Code.

(s) Derivatives and Hedging Activities

The Corporation has utilized interest rate swap agreements to hedge variable interest rates; which were accounted for using Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities.* The Corporation's interest rate swap was carried at fair value as determined by a third party. Changes in fair value were reported in the consolidated statements of activities and changes in net assets (liabilities) as a component of the change in net assets.

For 2005, the Corporation's interest rate swap expired resulting in an unrealized gain of $183,745. For 2004, an adjustment to the liability was recorded causing a gain of $333,759 representing a decrease in the fair value (liability) of the swap.

(continued)

(t) Reclassification

Certain amounts in the 2004 financial statements have been reclassified to conform to the 2005 financial statement presentation. These reclassifications had no effect on the changes in net assets (liabilities).

(u) Performance Indicator

The Corporation measures the performance of its operations using the statement of activities and changes in net assets (liabilities), which includes a performance indicator of operations labeled as "changes in net assets (liabilities) before unrealized (losses) gains on marketable securities". Changes in unrestricted net assets which are excluded from this measure are: unrealized (losses) gains on marketable securities, and other significant adjustments which do not directly indicate operational performance.

(3) Investments

The cost and fair value of investments at December 31 are as follows:

		2005		2004	
		Fair Value	Cost	Fair Value	Cost
Money market funds	$	22,626	22,626	2,033	2,033
Government agency securities		77,165	78,625	134,795	135,909
Corporate debt securities		67,900	70,000	44,313	45,000
Totals	$	167,691	171,251	181,141	182,942

The Corporation invests in a variety of individual fixed income investments including bonds issued by the US Government and its agencies, and corporate bonds. The Corporation has seven and eight of such individual holdings as of December 31, 2005 and 2004, respectively. All of these individual holdings have a market value below cost as of December 31, 2005 and December 31, 2004. The Corporation's policy is to hold the fixed income securities until maturity.

Two individual holdings have a market value that has been below cost for less than a year as of December 31, 2005. Five individual holdings had a market value that had been below cost for less than a year as of December 31, 2004. These are fixed income investments, and in total, the market value is less than one percent below cost for both 2005 and 2004. The Corporation believes the decline in market value of this holding is temporary in nature as it reflects general market conditions for bond and other fixed income securities instead of a permanent decline in the value of the individual security.

(continued)

(3) Investments (continued)

Five individual holdings have a market value that has been below cost for more than a year as of December 31, 2005. Two individual holdings had a market value that had been below cost for more than a year as of December 31, 2004. These are also fixed income investments, and in total, their market value is less than three percent and one percent below cost for 2005 and 2004, respectively.

A summary of investments with fair values below cost as of December 31, 2005 follows:

		Less than 12 Months		More than 12 Months		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	$	24,742	(133)	52,423	(1,327)	77,165	(1,460)
Corporate bonds		24,410	(590)	43,490	(1,510)	67,900	(2,100)
Total temporarily impaired securites	$	49,152	(723)	95,913	(2,837)	145,065	(3,560)

A summary of investments with fair values below cost as of December 31, 2004 follows:

		Less than 12 Months		More than 12 Months		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	$	107,922	1,123	46,191	798	154,113	1,921

(4) Related Party Transactions

The Corporation incurs a management fee payable to PHI under a Development, Marketing, and Management Agreement (Management Agreement). Under the Management Agreement, PHI provides a full-time licensed administrator who is responsible for the facility's operation, under the direction of PHI. For the years ended December 31, 2005 and 2004, the Corporation incurred fees under the agreement of $634,000 and $637,472, respectively, which are classified as general and administrative expenses on the consolidated statements of activities and changes in net assets (liabilities).

(continued)

(4) Related Party Transactions (continued)

Presbyterian Homes, Inc., a subsidiary of PHI, has guaranteed payment up to $6,000,000 to the extent collateral is insufficient to satisfy the outstanding debt of the Corporation as described in Note 8.

At December 31, 2005 and 2004 the amounts payable to PHI were $4,637,867 and $3,181,678, respectively. Under the Management Agreement, this is included in due to or from affiliated entity. Included in the 2004 amount is the January 2004 advance of $1,500,000 from PHI, which was used to retire the swap termination fee payable.

During 2005 and 2004, the Corporation purchased pharmaceuticals of $89,732 and $72,513, respectively from Continuing Care Rx Holding Company, Inc., of which $30,614 and $0 is included in accounts payable as of December 31, 2005 and 2004, respectively. As of December 29, 2004, PHI sold its majority interest in Continuing Care Rx Holding Company, Inc. and remains a minority shareholder.

In September 2004, PHI invested in Alliance Rehab HVA, L.L.C., obtaining a ten percent ownership in the limited liability company. Alliance Rehab HVA, L.L.C. operates a post acute rehabilitation delivery system and senior fitness programs primarily directed at nursing homes, assisted living facilities, independent living facilities, home Healthcare care provider, and community and fitness centers. During 2005 and 2004, the Corporation purchased services from Alliance Rehab for $197,296 and $36,176, respectively, of which $38,874 and $36,176 is included in accounts payable as of December 31, 2005 and 2004, respectively.

(5) Assets Whose Use is Limited

At December 31 assets whose use is limited consist of the following:

	2005	2004
Operating reserve fund	$ 1,229,344	1,109,789
Designated for renovation and charity care	542,104	502,698
Other reserves required by financing arrangement	170,023	155,644
	1,941,471	1,768,131
Less: current portion assets whose use is limited	(542,104)	(492,819)
Assets whose use is limited, net of net of current portion	$ 1,399,367	1,275,312

The Corporation's Board of Directors has designated certain funds toward the purpose of acquiring or renovating property and equipment and for providing charity care. These funds are primarily held in government agency securities, mutual funds and money market funds where the cost approximates fair value.

(continued)

(5) Assets Whose Use is Limited (continued)

The Corporation is required by the Maryland Department of Aging to maintain and fund an operating reserve based on the Corporation's operating expenses for the most recent fiscal year, excluding depreciation and amortization. The Department of Aging requires the Corporation to build the level of this operating reserve over a period not to exceed ten years beginning in 1997. Annual contributions to the operating reserve equaling at least 10% of the calculated reserve amount are required. For the year ended December 31, 2005, the fund balance was $1,229,344, representing cumulative contributions and earnings in satisfaction of the minimum operating reserve amount. Additional contributions of $64,134 are anticipated to be made during 2006 based on the following computation:

		2005
Total operating expenses (excluding interest rate swap of $183,745):	$	10,968,527
Less: Depreciation		(1,370,977)
Amortization		(16,229)
Total expenses subject to operating reserve computation	(A)	9,581,321
Operating reserve requirement – 15% of (A)	(B)	1,437,198
Minimum operating reserve as of year 10 – 90% of (B)		1,293,478
Contributions made through year 9		(1,229,344)
Contributions required for year ended December 31, 2006	$	64,134

(6) Commitments and Contingencies

The Corporation is involved in legal proceedings arising from its activities in the health care industry. Although it is not possible to presently determine the outcome of these matters, management believes the aggregate liability, if any, resulting from such proceedings will not have a material adverse effect on the Corporation's assets, liabilities, net assets, operations or cash flows.

(continued)

(7) Property and Equipment

A summary of property and equipment and accumulated depreciation at December 31 is as follows:

	2005		2004	
	Cost	**Accumulated depreciation**	**Cost**	**Accumulated depreciation**
Land	$ 14,800,000	—	14,800,000	—
Land improvements	2,027,098	1,012,582	2,014,412	919,567
Buildings and improvements	28,020,791	11,901,767	27,213,698	10,734,301
Departmental equipment, furniture and fixtures	1,873,618	1,431,790	1,825,634	1,321,560
Vehicles	166,674	164,635	166,674	164,369
Construction-in-progress	359,500	—	393,433	—
	$ 47,247,681	14,510,774	46,413,851	13,139,797
Net book value		$ 32,736,907		$ 33,274,054

Land consists of 483 acres, of which 60 acres are utilized for the facility. The remaining land is leased to independent parties and may be available for future expansion. As of December 31, 2005 and 2004, commitments for future construction totaled approximately $623,600 and $850,000, respectively.

(8) Bonds payable

Bonds payable as of December 31 consisted of the following:

	2005	2004
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999A, tax exempt variable rate debenture bonds, principal maturities in varying amounts from 2012 to 2029, interest adjusted weekly, 3.35% at December 31, 2005, collateralized by letter of credit	$ 3,340,000	3,340,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999B, taxable variable rate debenture bonds, principal maturities in varying amounts from 2001 to 2029, interest adjusted weekly, 4.37% at December 31, 2005, collateralized by letter of credit	15,740,000	16,045,000
	19,080,000	19,385,000
Less: current portion bonds payable	(330,000)	(305,000)
	$ 18,750,000	19,080,000

Maturities for the five years subsequent to December 31, 2005 and thereafter are as follows:

Years ended December 31,	
2006	$ 330,000
2007	350,000
2008	375,000
2009	405,000
2010	435,000
Thereafter	17,185,000
	$ 19,080,000

The irrevocable letter of credit, which serves as collateral for the Corporation's bonds payable requires the Corporation to pay an annual fee approximating 1.50% of the principal balance of bonds outstanding. This letter of credit expires August 2007 and is collateralized by property and equipment and gross revenues of the Corporation.

(continued)

(8) Bonds payable (continued)

The Corporation had a swap agreement with a financial intermediary which fixed the interest rate to be paid by the Corporation on a portion of the taxable bonds. The swap, which had a notional amount of $6,000,000 and had an interest rate of 6.88%, expired September 15, 2005. Pursuant to this agreement the intermediary assumed the risk of varying interest rates, with the difference between the weekly variable rates and the fixed rates above being either paid by, or reimbursed to, the Corporation. As discussed in Note 2, the swap agreement was reported at fair value.

(9) Note Payable

The Corporation has available a line of credit with a financial institution. Borrowings under this line of credit arrangement vary with the prime rate. As of December 31, 2005, interest on outstanding borrowings was at 7.25%. Under the line of credit agreement, the Corporation had available maximum borrowings of $1,250,000. As of December 31, 2005 and 2004, the Corporation's outstanding borrowings under the line of credit agreement were $676,000 and $387,000, respectively. The line of credit expires on May 31, 2006.

(10) Leases

The Corporation leases certain equipment under operating leases, which expire at various dates through 2009. The future minimum lease payments under these operating leases are as follows:

2006	$ 31,515
2007	30,177
2008	25,741
2009	8,118
	$ 95,551

Rental expense under operating leases was $52,256 and $66,245 for the years ended December 31, 2005 and 2004, respectively.

(continued)

(11) Annuities

The Corporation has a gift annuity program. In return for their gifts, donors are paid a fixed annuity amount during the lifetime of the donor and/or the donor's beneficiary, which creates a liability of the Corporation. Total annuities payable were $85,205 and $91,382 at December 31, 2005 and 2004, respectively. The Corporation uses published mortality-rate tables adopted by the United States Internal Revenue Service and an assumed discount rate of approximately four percent to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of $167,691 and $181,141 as of December 31, 2005 and 2004, respectively to satisfy annuities.

(12) Charity Care

The Corporation provides care to residents who meet certain criteria under its charity care policy at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. In addition, the Corporation considers contractual allowances charity care. The total amount of charity care provided under these policies were approximately $212,135 and $94,245 for the years ended December 31, 2005 and 2004, respectively, of which the amount of charges foregone for services and supplies were approximately $37,190 and $59,350 for 2005 and 2004, respectively.

(13) Retirement Plan

The Corporation participates in the defined-contribution retirement plan of Presbyterian Homes, Inc., an affiliate. This plan covers all employees that have completed one year of service and have reached the age of 21. Vesting occurs after five years of service. Contributions to the plan are at the discretion of the Board of Trustees of PHI. For the years ended December 31, 2005 and 2004, retirement plan expense totaled approximately $87,300 and $58,400, respectively. Starting in 2006, the Corporation will be allowing employee the ability to direct how their contributions are invested. Also in 2006, the vesting period will change from 5 years to 3 years.

(14) Fair Values of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents: The carrying amount approximates fair value because of the short term nature of those investments.

Marketable securities: The fair values of marketable securities are estimated based on quoted market prices for those or similar investments.

(14) Fair Values of Financial Instruments (continued)

Long-term debt: The carrying amount included in long-term debt in the statement of financial position for bonds payable approximates the fair value.

The Corporation has a number of other financial instruments, none of which are held for investment purposes. The Corporation estimates that the fair value of all financial instruments at December 31, 2005 and 2004 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statements of financial position.

(15) Subsequent Events

In January 2006, the Corporation entered into a sales agreement with Gaylord Brooks Realty Co., Inc. Under the agreement, the Corporation agrees to sell approximately 15 acres of land which the buyer will purchase to develop residential living. The price of the land will be determined based on the number and type of units built. The buyer will pay $65,000 per condominium unit, $100,000 for each villa and $125,000 for each duplex, plus additional amounts based on the selling price of the units. The contract is subject to the approval of the development plans by various state and local government agencies.