

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Financial Statements

December 31, 2016 and 2015

(With Independent Auditor's Report Thereon)



PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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Certification of Chief Executive and Chief Financial Officers

We are responsible for the consolidated financial statements of Presbyterian Senior Living Services, Inc., as of December 31, 2016 and 2015, 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 Presbyterian Senior Living 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.

Consolidated 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 consolidated financial statements disclose information that is important to create a complete picture of our stewardship of financial resources.

Consolidated 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 90 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 Presbyterian Senior Living's mission.

Stephen E. Proctor
Chief Executive Officer
Presbyterian Senior Living

Jeffrey J. Davis
Chief Financial Officer
Presbyterian Senior Living



Independent Auditor's Report

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The Board of Directors
Presbyterian Senior Living Services, Inc.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Presbyterian Senior Living Services, Inc. (an affiliate of PHI, doing business as Presbyterian Senior Living) (the Corporation) which comprise the consolidated statements of financial position as of December 31, 2016 and 2015, and the related consolidated statements of operations and changes in net assets (liabilities) and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entities' preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entities' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Going Concern

The accompanying consolidated financial statements have been prepared assuming that Presbyterian Senior Living Services, Inc. will continue as a going concern. As discussed in Note 18 to the consolidated financial statements, the Corporation has suffered recurring losses from operations; its total liabilities exceeds total assets; and the Corporation's continued operations are dependent upon the continued support of Presbyterian Senior Living. This raises substantial doubt about the Corporation's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this support.

Arnett Carbis Toothman LLP

Arnett Carbis Toothman LLP
New Castle, Pennsylvania
April 7, 2017

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Financial Position

December 31, 2016 and 2015

Assets	2016	2015
Cash and cash equivalents	\$ 216,790	112,912
Investments	1,400,000	1,300,000
Restricted deposits and funded reserves	1,876,567	1,805,802
Accounts receivable, net	914,865	566,752
Prepaid expenses and other current assets	237,044	206,892
Assets whose use is limited	1,035,701	1,017,905
Pledges receivable	–	5,000
Property and equipment (net of accumulated depreciation of \$32,746,628 and \$30,812,878, respectively)	28,834,600	29,455,912
Assets under capital leases (net of accumulated amortization of \$66,395 and \$49,881, respectively)	20,644	37,158
Total assets	<u>\$ 34,536,211</u>	<u>34,508,333</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Financial Position

December 31, 2016 and 2015

Liabilities and Net Liabilities	2016	2015
Accounts payable	\$ 631,472	631,936
Accrued expenses	486,861	475,818
Resident deposits	56,840	24,000
Entrance fees payable	14,965,039	16,011,397
Deferred revenue – entrance fees	4,188,772	3,858,083
Annuities payable	28,694	51,989
Obligations under capital leases	21,215	37,721
Bonds payable	13,671,191	14,304,962
Due to affiliated entity	24,768,163	22,756,431
Total liabilities	<u>58,818,247</u>	<u>58,152,337</u>
Net assets (liabilities):		
Unrestricted	(24,891,928)	(24,235,365)
Temporarily restricted	233,588	217,257
Permanently restricted	376,304	374,104
Total net liabilities	<u>(24,282,036)</u>	<u>(23,644,004)</u>
Total liabilities and net liabilities	<u>\$ 34,536,211</u>	<u>34,508,333</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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

Years ended December 31, 2016 and 2015

	2016	2015
Operating revenues, gains, and other support:		
Resident services, including amortization of entrance fees of \$821,365 and \$841,134, respectively	\$ 12,598,701	13,082,574
Interest and dividend income	106,751	134,318
Realized gains (losses) on investments	52,048	(62,204)
Gains on sale of property and equipment	–	20,404
Contributions, gifts and bequests	6,357	51,527
Net assets released from restrictions	7,504	2,448
Total operating revenues, gains, and other support	12,771,361	13,229,067
Expenses:		
Nursing services	2,275,206	2,419,867
Rehabilitation	536,834	707,663
Recreation and special services	479,899	496,942
Pharmacy	104,928	84,736
Social services	65,633	59,512
Physician services	25,000	25,000
Food services	2,029,191	2,039,377
Building operations and maintenance	2,360,817	2,511,961
Housekeeping	357,750	407,414
Laundry and linen	49,488	50,909
General and administrative	2,182,511	2,170,132
Employee benefits	680,955	696,171
Interest	318,292	276,891
Depreciation	1,950,263	1,902,583
Amortization	16,229	16,229
Fundraising and investment fees	57,081	57,115
Total expenses	13,490,077	13,922,502
Deficit of operating revenues, gains, and other support over expenses	(718,716)	(693,435)
Other changes:		
Unrealized gains (losses) on investments	62,153	(261,548)
Change in unrestricted net liabilities	(656,563)	(954,983)

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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

Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Temporarily restricted net assets:		
Contributions, gifts and bequests	6,215	233
Interest and dividend income	17,620	17,128
Net assets released from restrictions	<u>(7,504)</u>	<u>(2,448)</u>
Change in temporarily restricted net assets	<u>16,331</u>	<u>14,913</u>
Permanently restricted net assets:		
Contributions	<u>2,200</u>	<u>2,000</u>
Change in permanently restricted net assets	<u>2,200</u>	<u>2,000</u>
Change in net liabilities	(638,032)	(938,070)
Net liabilities, beginning of year	<u>(23,644,004)</u>	<u>(22,705,934)</u>
Net liabilities, end of year	<u>\$ (24,282,036)</u>	<u>(23,644,004)</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Change in net liabilities	\$ (638,032)	(938,070)
Adjustments to reconcile change in net liabilities to net cash provided by operating activities:		
Depreciation	1,950,263	1,902,583
Provision for bad debts	(20,936)	(16,374)
Proceeds from non-refundable entrance fees and deposits	3,885,969	4,140,044
Amortization of entrance fees	(821,365)	(841,134)
Unrealized (gains) losses on investments	(62,153)	261,548
Realized (gains) losses on investments	(52,048)	62,204
Gains on sale of property and equipment	-	(20,404)
Contributions restricted for long-term purposes	(2,200)	(2,000)
Amortization	16,229	16,229
Change in assets and liabilities:		
Accounts receivable	(171,617)	231,593
Entrance fees receivable	(155,560)	(65,409)
Pledges receivable	5,000	(5,000)
Prepaid expenses and other current assets	(30,152)	62,233
Accounts payable	(464)	(433,966)
Accrued expenses	11,043	52,036
Net cash provided by operating activities	<u>3,913,977</u>	<u>4,406,113</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(1,312,437)	(1,287,153)
Net proceeds from sale of property and equipment	-	179,782
Purchases of investments	(3,292,873)	(1,764,012)
Proceeds from sale of investments	3,218,513	1,645,422
Net cash used in investing activities	<u>(1,386,797)</u>	<u>(1,225,961)</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(2,701,075)	(3,160,152)
Change in entrance fee payable	(1,046,358)	(1,277,254)
Principal payments and redemptions of bonds	(650,000)	(610,000)
Repayments on capital lease obligations	(16,506)	(20,412)
Contributions restricted for long-term purposes	2,200	2,000
Change in annuities payable	(23,295)	24,110
Change in due to affiliated entity	2,011,732	1,730,932
Net cash used in financing activities	<u>(2,423,302)</u>	<u>(3,310,776)</u>
Net increase (decrease) in cash and cash equivalents	103,878	(130,624)
Cash and cash equivalents, beginning of year	<u>112,912</u>	<u>243,536</u>
Cash and cash equivalents, end of year	\$ <u>216,790</u>	<u>112,912</u>
Supplemental schedule of non-cash investing activities		
Decrease in assets held for sale through increase in property and equipment	\$ <u>-</u>	<u>39,724</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(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 operations 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, doing business as Presbyterian Senior Living, the Corporation's parent organization, the residents of Glen Meadows and the Presbytery of Baltimore.

The Community contains 112 independent living cottages, 89 independent living apartments, 36 assisted living units and a 31-bed skilled nursing facility. The Community 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 were 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 Presbyterian Senior Living, located in Dillsburg, 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.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(b) Basis of Accounting (continued)

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

(c) Income Taxes

The Corporation and its subsidiaries are not-for-profit organizations as described in Section 501(c)(3) of the Internal Revenue Code (Code) and have been recognized as tax exempt under Section 501(a) of the Code.

The Corporation follows the Financial Accounting Standards Board (FASB) accounting standard for accounting for uncertainty in income taxes. This standard clarifies the accounting for uncertainty in income taxes in a company's consolidated financial statements and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. The standard also provides guidance on derecognition, classification, interest and penalties, and disclosure. Management has determined that this standard does not have a material impact on the consolidated financial statements.

The Corporation is part of a consolidated federal Exempt Organization Business Income Tax Return for which the years ended December 31, 2013, 2014 and 2015, remain subject to examination by the Internal Revenue Service.

(d) Use of Estimates

The preparation of consolidated financial statements in accordance 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 consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(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 consolidated statements of financial position and cash flows, except for those included in investments or assets whose use is limited. The Corporation's cash and cash equivalents are insured by the Federal Deposit Insurance Corporation (FDIC) for up to \$250,000 per bank. At times during 2016 and 2015, the Corporation's cash balances may have exceeded the FDIC coverage. The Corporation has not experienced any loss in these accounts.

(f) Investments

Investments in marketable equity securities and mutual funds with readily determinable fair values and all investments in debt securities are measured at fair value as determined by a national exchange on the consolidated 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, 2016 and 2015, no amounts were charged to realized loss for this purpose as management believes the decline in value is temporary due to general economic conditions and not an other than temporary decline in value.

Investment income (loss) consisted of the following for the years ended December 31:

	<u>2016</u>	<u>2015</u>
Interest and dividends	\$ 124,371	151,446
Realized gains (losses) on investments	52,048	(62,204)
Unrealized gains (losses) on investments	<u>62,153</u>	<u>(261,548)</u>
	<u>\$ 238,572</u>	<u>(172,306)</u>

Investment expenses of \$14,112 and \$14,060, for the years ended December 31, 2016 and 2015, respectively, have been included in fundraising and investment fees on the consolidated statements of operations and changes in net assets (liabilities).

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(g) Accounts Receivable

Accounts receivable are shown net of an estimated allowance for doubtful accounts is as follows as of December 31:

	<u>2016</u>	<u>2015</u>
Total accounts receivable	\$ 949,063	647,053
Less: allowance for doubtful accounts	<u>(34,198)</u>	<u>(80,301)</u>
Net accounts receivable	<u>\$ 914,865</u>	<u>566,752</u>

The allowance for doubtful accounts is established based on management's assessment of the collectability of specific customer accounts and the aging of the accounts receivable. Losses are charged against the allowance for doubtful accounts when management believes the uncollectability of a receivable is likely. During 2016 management reviewed the estimate related to the manner in which the allowance for doubtful accounts is calculated to provide a better estimate of the amounts reasonably expected to be collected. Prior to the change, aged receivables older than six months were fully reserved. Under the new estimate, receivables aged older than six months are reserved at the following amounts:

Private pay	75%
Managed care and other	100%
Medicaid and Medicaid pending	20%
Coinsurance	75%
Medicare Part A and B	20%

The impact of the change in estimate is a decrease to the allowance for doubtful accounts by \$23,000.

(h) Restricted Deposits and Funded Reserves

Restricted deposits and funded reserves are measured at fair value in the consolidated statements of financial position and include the Maryland Department of Aging Operating Reserve.

(i) Assets Whose Use is Limited

Assets whose use is limited are measured at fair value on the consolidated statements of financial position and include money deposited with a trustee under a debt agreement and assets restricted by donors for capital improvements and charity care.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(j) *Property and Equipment and Assets under Capital Leases*

Property and equipment and assets under capital leases 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 for property and equipment. Depreciation is being provided on the straight-line method over the shorter of estimated useful lives of assets, or the lease term for assets under capital leases. The Corporation's policy is to capitalize items in excess of \$3,000 or for a group of items that are the same or similar in nature or function as a group totaling \$3,000 or more.

Depreciable lives are determined as follows:

Land improvements	15-25 years
Buildings and improvements	10-40 years
Departmental equipment, furniture, and fixtures	10-25 years
Vehicles	5 years

(k) *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. Amortization expense is expected to be \$16,229 for each of the next five years. Guidance was issued that requires deferred financing costs related to a recognized debt liability to be presented on the consolidated statements of financial position as a direct deduction from the carrying amount of the related debt liability. The Corporation adopted this guidance during the year ended December 31, 2016 (Note 9).

(l) *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 on the consolidated statements of financial position. These deposits are transferred to deferred revenue upon occupancy of the related independent living units.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(m) *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. For the 100% refundable contracts, entrance fees are refundable in full upon termination of the agreement and subsequent reoccupancy of the unit. These entrance fees are not being amortized into revenue and are reflected as a liability in entrance fee payable on the consolidated statements of financial position. The Community also offers a 50% and a 75% nonrefundable contract. The non-refundable portion of the fees is amortized to income over the estimated remaining life expectancy of each resident. The portion of the guaranteed fee refundable upon reoccupancy is not being amortized and is reflected as a liability in entrance fee payable on the consolidated statements of financial position. The agreements provide for potential death or termination refunds of the non-refundable portion if reoccupancy occurs before the contractual amortization is completed in accordance with the terms of the agreements. The remaining amount of unamortized, nonrefundable entrance fees is recorded as revenue upon surrender of the independent living unit.

As of December 31, 2016 and 2015, the amount of entrance fees guaranteed to be refundable to residents under contractual refund provisions was \$14,965,039 and \$16,011,397, respectively.

(n) *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. Income from the permanently restricted net assets is primarily to be used for resident welfare.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(o) 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 on the consolidated statements of operations 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.

(p) 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.

Skilled nursing services provided to Medicare beneficiaries are paid under the terms of a prospective payment system ("PPS") at predetermined rates based on clinical, diagnostic, and other factors.

Nursing services provided to Medicaid beneficiaries are paid at prospectively determined rates per day. These rates vary according to a resident classification system that is based on clinical diagnosis and other factors, and the reimbursement methodology is subject to various limitations and adjustments. 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 18% and 20% of consolidated revenues for 2016 and 2015, respectively. Medicare and Medicaid receivables represent approximately 31% and 39% of consolidated accounts receivable as of December 31, 2016 and 2015, respectively.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(q) Charity Care

The Corporation follows the Financial Accounting Standards Board accounting standards update. This standard provides improved disclosures about charity care to prescribe a specific measurement basis of charity care. This guidance prescribed that the amount of charity care disclosed in the consolidated financial statements should be measured based on the providers direct and indirect costs of providing charity care services. The guidance also provided that if costs cannot be specifically attributed to services provided to charity care patients, that reasonable techniques could be used to estimate these costs, and that these techniques should be disclosed and that any funds received to offset or subsidize charity care services also should be disclosed.

The Corporation's policy is to provide services without charge, or at amounts less than its established rates, to residents who meet the certain need based criteria. These criteria consider resident income and expenses, financial resources, state and federal government requirements, and other sources of payment for services which may be provided. The Corporation also receives donations and income from permanently restricted trusts and investments designated to the needs of its residents under this policy.

Amounts the Corporation provided and received for resident financial support are as follows for the years ended December 31:

	<u>2016</u>	<u>2015</u>
Charity care provided at the estimated cost thereof, net of amounts received from residents and third-party payors	\$ 415,917	407,561
Additional benevolent care provided at amounts less than pre-established charges for private pay services	552,017	328,524
Giving and income designated for resident financial support	23,591	33,273

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(r) *Classification of Expenses*

Expenses incurred are classified as follows for the years ended December 31:

	<u>2016</u>	<u>2015</u>
Program activities	\$ 11,250,485	11,695,255
General and administrative	2,196,623	2,184,192
Fundraising	42,969	43,055
	<u>\$ 13,490,077</u>	<u>13,922,502</u>

(s) *Advertising*

Advertising costs are expensed in the years incurred. Total advertising expense for the years ended December 31, 2016 and 2015, were \$13,046 and \$11,707, respectively.

(t) *Contributed Services*

Contributed services are reflected in the accompanying consolidated financial statements at their estimated fair value at the date of receipt to the extent they create or enhance nonfinancial assets or require specialized skills which, if not provided by donation, would have to be purchased by the Corporation. No amounts have been included in the accompanying consolidated financial statements as amounts are not material.

(u) *Performance Indicator*

The Corporation measures the performance of its operations using the consolidated statements of operations and changes in net assets (liabilities), which includes a performance indicator of operations labeled as "Deficit of operating revenues, gains, and other support over expenses." Changes in unrestricted net (liabilities) which are excluded from this measure are unrealized gains (losses) on investments.

(v) *Consolidated Statements of Cash Flows*

Interest paid for the years ended December 31, 2016 and 2015, amounted to \$315,890 and \$276,571, respectively.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(w) Reclassifications

Certain reclassifications have been made to the 2015 consolidated financial statements to conform to the presentation of 2016.

(x) Subsequent Events

The Corporation has adopted the standard related to subsequent events. This standard provides guidance on accounting for and disclosure of events that occur after the consolidated statement of financial position date but before consolidated financial statements are issued or are available to be issued.

The Corporation has evaluated subsequent events through April 7, 2017, which is the date the consolidated financial statements were released.

(3) Investments

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

	2016		2015	
	Fair Value	Cost	Fair Value	Cost
Money market funds	\$ 375,461	375,461	359,807	359,807
Equity securities	3,210,931	3,160,495	3,174,500	3,165,855
Fixed income securities	725,876	750,474	589,400	616,615
Totals	4,312,268	4,286,430	4,123,707	4,142,277
Less:				
Restricted deposits and funded reserves (Note 5)	(1,876,567)		(1,805,802)	
Assets whose use is limited (Note 6)	(1,035,701)		(1,017,905)	
Total investments	\$ 1,400,000		1,300,000	

The Corporation holds its investments in the operating reserve fund. These assets are invested in a diversified portfolio of mutual funds. The Corporation had twenty mutual funds as of December 31, 2016 and 2015. As of December 31, 2016, ten mutual funds had a market value below cost and as of December 31, 2015, twelve mutual funds had a market value below cost.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(3) Investments (continued)

Six mutual funds had a market value that had been below cost for less than a year as of December 31, 2016. In total, their market value of the loss was less than three percent below cost for 2016. Eleven mutual funds had a market value that had been below cost for less than a year as of December 31, 2015. In total, their market value of the loss was less than nine percent below cost for 2015.

Four mutual funds had a market value that had been below cost for more than one year as of December 31, 2016. In total, their market value was less than seven percent below cost for 2016. One mutual fund had a market value that had been below cost for more than one year as of December 31, 2015. In total, its market value was less than four percent below cost for 2015.

A summary of investments with fair values below cost as of December 31, 2016, follows:

	<u>Less than 12 Months</u>		<u>More than 12 Months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Mututal funds	\$ <u>1,143,136</u>	<u>(26,857)</u>	<u>951,830</u>	<u>(63,306)</u>	<u>2,094,966</u>	<u>(90,163)</u>
Total temporarily impaired investments	\$ <u><u>1,143,136</u></u>	<u><u>(26,857)</u></u>	<u><u>951,830</u></u>	<u><u>(63,306)</u></u>	<u><u>2,094,966</u></u>	<u><u>(90,163)</u></u>

A summary of investments with fair values below cost as of December 31, 2015, follows:

	<u>Less than 12 Months</u>		<u>More than 12 Months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Mututal funds	\$ <u>1,989,884</u>	<u>(195,240)</u>	<u>397,991</u>	<u>(14,867)</u>	<u>2,387,875</u>	<u>(210,107)</u>
Total temporarily impaired investments	\$ <u><u>1,989,884</u></u>	<u><u>(195,240)</u></u>	<u><u>397,991</u></u>	<u><u>(14,867)</u></u>	<u><u>2,387,875</u></u>	<u><u>(210,107)</u></u>

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(4) Related Party Transactions

The Corporation incurs a management fee payable to Presbyterian Senior Living, under a Development, Marketing, and Management Agreement (Management Agreement). Under the Management Agreement, Presbyterian Senior Living provides a full-time licensed administrator who is responsible for the Community's operation, under the direction of Presbyterian Senior Living, a full-time bookkeeper and a human resources employee. The Corporation incurred fees under the agreement of \$1,240,548 and \$1,175,220 for the years ended 2016 and 2015, respectively. This fee is classified as general and administrative expenses on the consolidated statements of operations and changes in net assets (liabilities).

The Obligated Group, which consists of several subsidiaries of Presbyterian Senior Living, has guaranteed full payment to the extent collateral is insufficient to satisfy the outstanding debt of the Corporation as described in Note 9.

As of December 31, 2016 and 2015, the amounts payable to Presbyterian Senior Living were \$24,768,163 and \$22,756,431, respectively. Under the Management Agreement, this is included in due to affiliated entity on the consolidated statements of financial position.

Prelude Systems, Inc. (Prelude) is a joint venture between Presbyterian Senior Living and Diakon Lutheran Social Ministries (Diakon). Prelude is an information technology services organization with a wide range of programs designed to support the information systems needs of Presbyterian Senior Living and Diakon as well as other health care and community service organizations. During 2016 and 2015, the Corporation incurred expenses related to Prelude of \$95,736 and \$132,564, respectively, for information services provided by Prelude, of which \$3,564 and \$7,339 is included in accounts payable as of December 31, 2016 and 2015, respectively.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(5) Restricted Deposits and Funded Reserves

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 required 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 15% of the calculated reserve amount are required. As of December 31, 2016, the operating reserve fund balance was \$1,876,567, representing cumulative contributions and earnings in satisfaction of the minimum operating reserve amount. No additional contributions are anticipated to be made during 2017 based on the following computation:

Total 2015 operating expenses:	\$	13,922,502
Less: Depreciation		(1,902,583)
Amortization		<u>(16,229)</u>
Total expenses subject to operating reserve computation	(A)	<u><u>12,003,690</u></u>
Operating reserve requirement – 15% of (A)		1,800,554
Operating reserve fund as of December 31, 2016		<u>1,876,567</u>
Excess contributions as of December 31, 2016	\$	<u><u>(76,013)</u></u>

(6) Assets Whose Use is Limited

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

	<u>2016</u>	<u>2015</u>
Designated for renovation and charity care	\$ 694,303	696,134
Other reserves required by financing arrangement	<u>341,398</u>	<u>321,771</u>
Assets whose use is limited	<u><u>\$ 1,035,701</u></u>	<u><u>1,017,905</u></u>

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.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(7) 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.

(8) Property and Equipment

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

	2016		2015	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Land	\$ 14,182,370	–	14,182,370	–
Land improvements	3,020,156	2,238,917	3,016,607	2,100,209
Buildings and improvements	41,334,808	27,903,388	39,941,622	26,206,159
Departmental equipment, furniture and fixtures	2,757,928	2,348,330	2,640,996	2,250,517
Vehicles	255,993	255,993	255,993	255,993
Construction-in-progress	29,973	–	231,202	–
	\$ 61,581,228	32,746,628	60,268,790	30,812,878
Net book value		\$ 28,834,600		\$ 29,455,912

Land consists of 483 acres, of which 60 acres are utilized for the Community. The remaining land is leased to independent parties and may be available for future expansion.

In 2015, management sold the last of six rental properties that were all located within the community. The final unit was sold for approximately \$180,000 and a gain of \$20,404 was recognized.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(9) Bonds Payable

Bonds payable as of December 31 consist of the following:

	<u>2016</u>	<u>2015</u>
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, 0.70% and 0.01% as of December 31, 2016 and 2015, respectively, collateralized by letter of credit	\$ 2,690,000	2,835,000
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, 0.70% and 0.35% as of December 31, 2016 and 2015, respectively, collateralized by letter of credit	11,165,000 <u>13,855,000</u>	11,670,000 <u>14,505,000</u>
Less: Deferred financing costs	<u>(183,809)</u>	<u>(200,038)</u>
Total bonds payable	\$ <u><u>13,671,191</u></u>	<u><u>14,304,962</u></u>

Under the terms of the Corporation's 1999 Maryland Health and Higher Educational Facility Authority Revenue Bond indenture, the Corporation is required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indenture also places limits on the incurrence of additional borrowings and requires the Corporation to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants were met as of December 31, 2016 and 2015.

Maturities for the five years subsequent to December 31, 2016, and thereafter are as follows:

<u>Years ending December 31,</u>	
2017	\$ 695,000
2018	745,000
2019	795,000
2020	845,000
2021	905,000
Thereafter	<u>9,870,000</u>
	\$ <u><u>13,855,000</u></u>

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(9) Bonds Payable (continued)

The Corporation has outstanding two letters of credit as of December 31, 2016, as required by the bonds. These letters of credit require the Corporation to pay an annual fee of approximately 1.55% of the principal balance of bonds outstanding. The letters of credit expire March 31, 2018. The letters of credit are collateralized by property and equipment and gross revenues of the Corporation. As described in Note 4, the Obligated Group, which consists of several subsidiaries of Presbyterian Senior Living, has guaranteed full payment to the extent collateral is insufficient to satisfy the outstanding debt of the Corporation.

(10) Leases

The Corporation is obligated under a capital lease for equipment that will expire in 2018. As of December 31 the gross amount of the equipment and the related accumulated amortization recorded under capital leases was as follows:

	<u>2016</u>	<u>2015</u>
Equipment	\$ 87,039	87,039
Accumulated amortization	<u>(66,395)</u>	<u>(49,881)</u>
	<u>\$ 20,644</u>	<u>37,158</u>

A schedule of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2016, follows:

2017	\$ 16,200
2018	<u>5,400</u>
	21,600
Amounts representing interest	<u>(385)</u>
Present value of minimum lease payments	<u>\$ 21,215</u>

Amortization expense of \$16,514 and \$20,708 for the years ended December 31, 2016 and 2015, respectively, for the assets held under capital leases is included in depreciation expense on the consolidated statements of operations and changes in net assets (liabilities). Interest rates on the capital leases range from 2.5% to 2.6% for the years ended December 31, 2016 and 2015.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(10) Leases (continued)

The Corporation leases certain equipment under operating leases, which expire at various dates through 2017. The future minimum lease payments under these operating leases are as follows as of December 31, 2016:

2017	\$ <u>14,496</u>
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Rental expense under operating leases was \$65,264 and \$52,988 for the years ended December 31, 2016 and 2015, respectively.

(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 was \$28,694 and \$51,989 as of December 31, 2016 and 2015, 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 approximately \$135,000 and \$167,000 as of December 31, 2016 and 2015, respectively, to satisfy annuities.

(12) Retirement Plan

The Corporation participates in the defined-contribution retirement plan of Presbyterian Senior Living. This plan covers all employees who have completed one year of service and have reached the age of 21. Vesting occurs after three years of service. Contributions to the plan are at the discretion of the Board of Trustees of Presbyterian Senior Living, and employees have the ability to direct how their contributions are invested. For the years ended December 31, 2016 and 2015, retirement plan expense totaled approximately \$90,000 and \$92,800, respectively.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(13) Medical Malpractice Claims Coverage

The Corporation maintains professional liability coverage on a claims-made basis through a commercial insurance carrier. Other than for premiums paid under this policy, no provision has been made for estimated losses. Management believes no incidents have occurred or will be asserted that will exceed the Corporation's insurance coverages or will have a material adverse effect on the consolidated financial statements.

(14) Temporarily Restricted Net Assets

Temporarily restricted net assets as of December 31 are available for the following purposes:

Endowment:	<u>2016</u>	<u>2015</u>
Benevolent Care	\$ 220,539	204,390
Scholarships	<u>1,479</u>	<u>1,171</u>
	222,018	205,561
Other	<u>11,570</u>	<u>11,696</u>
	<u>\$ 233,588</u>	<u>217,257</u>

Net assets of \$7,504 and \$2,448 were released from restriction during 2016 and 2015, respectively, in satisfaction of the above restrictions.

(15) Permanently Restricted Net Assets

Permanently restricted net assets are allocated for the following purposes as of December 31:

Endowment:	<u>2016</u>	<u>2015</u>
Benevolent Care	\$ 327,453	326,253
Scholarship	<u>48,851</u>	<u>47,851</u>
	<u>\$ 376,304</u>	<u>374,104</u>

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(16) Endowment

The endowments consist of donor restricted funds established for a variety of purposes supporting the Corporation. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Trustees of the Corporation has interpreted the relevant state law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Corporation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as unrestricted and temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by the relevant state law and donor imposed stipulations. Unless specifically defined, a donor-restricted endowment fund that is required by donor stipulation to accumulate or appropriate endowment funds, the Corporation considers the following factors:

- (1) The duration and preservation of the fund
- (2) The purposes of the organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(16) Endowment (continued)

The following schedule represents the changes in endowment net assets for the year ended December 31, 2016.

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 205,561	374,104	579,665
Investment return:			
Investment income	17,620	–	17,620
Contributions	–	2,200	2,200
Appropriation of endowment assets for expenditures	<u>(1,163)</u>	<u>–</u>	<u>(1,163)</u>
Endowment net assets, end of year	\$ <u>222,018</u>	<u>376,304</u>	<u>598,322</u>

The following schedule represents the changes in endowment net assets for the year ended December 31, 2015.

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 190,881	372,104	562,985
Investment return:			
Investment income	17,128	–	17,128
Contributions	–	2,000	2,000
Appropriation of endowment assets for expenditures	<u>(2,448)</u>	<u>–</u>	<u>(2,448)</u>
Endowment net assets, end of year	\$ <u>205,561</u>	<u>374,104</u>	<u>579,665</u>

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(16) Endowment (continued)

Funds with Deficiencies

The fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the relevant state law requires the Corporation to retain as a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, these deficiencies are reported as unrestricted net assets. There were no such deficiencies reported as of December 31, 2016 or 2015.

Return Objectives and Risk Parameters

The Corporation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Corporation must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of a composite of public market indexes based on the mix of investments held, while assuming a moderate level of investment risk. The Corporation expects its endowment funds, over time, to provide an average rate of return of approximately the consumer price index plus the investment spending percentage plus one percent annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

The Corporation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Corporation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(16) Endowment (continued)

Endowment Spending Policy and How the Investment Objectives Relate to the Spending Policy

The Corporation has a total return policy for calculating the amounts available for distribution each year. It is a percent of its endowment fund's average fair value over the prior three calendar year ends. This percentage was 3.0% for both 2016 and 2015. Actual distributions are for specific projects approved by the Board of Directors. If the total return amount exceeds the actual earnings of the endowment funds in any one year, then the amount needed to fund such excess will first be taken from the accumulated excess earnings from prior years, then from the accumulated net capital gains of endowment funds and, conversely, any undistributed income after the allocation of the total return distribution is added back to the unrestricted or temporarily restricted fund balance. In establishing this policy, the Corporation considered the long-term expected return on its endowment assets. Accordingly, over the long term, the Corporation expects the current spending policy to allow its endowment funds to grow at an average of inflation plus one percent annually. For both 2016 and 2015 an allocation of three percent of the prior year's balance was used to calculate restricted funds available balance. This is consistent with the Corporation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

(17) Financial Instruments

(a) Fair Values of Financial Instruments

The following valuation techniques were used to measure the fair value of each class of financial instruments:

Money market funds, equity and fixed income securities: Fair value of money market funds and equity and fixed income securities was based on quoted market prices for the identical security.

Long-term debt: Long-term debt is carried at cost on the consolidated statements of financial position for bonds payable as of December 31, 2016 and 2015. Fair value is based on quoted market prices for the same or similar issues. The total outstanding was \$13,855,000 and \$14,505,000 as of December 31, 2016 and 2015, respectively. The carrying amounts of these bonds payable approximate their fair value.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(17) Financial Instruments (continued)

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 as of December 31, 2016 and 2015, does not differ materially from the aggregate carrying values of its financial instruments recorded on the accompanying consolidated statements of financial position.

The standards for accounting for fair value measurements established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under these standards are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. There have been no changes in the methodologies used to measure fair value as of December 31, 2016 or 2015.

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used as of December 31, 2016, are as follows:

<u>Description</u>	<u>Total</u>	<u>Level 1</u>
Money market funds	\$ 375,461	375,461
Equity securities	3,210,931	3,210,931
Fixed income securities	725,876	725,876
Total investments	<u>\$ 4,312,268</u>	<u>4,312,268</u>

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

(17) Financial Instruments (continued)

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used as of December 31, 2015, are as follows:

<u>Description</u>	<u>Total</u>	<u>Level 1</u>
Money market funds	\$ 359,807	359,807
Equity securities	3,174,500	3,174,500
Fixed income securities	589,400	589,400
Total investments	<u>\$ 4,123,707</u>	<u>4,123,707</u>

(b) *Financial Instruments with Off-Balance-Sheet Risk*

Financial instruments with off-balance-sheet risk to the Corporation consist of certain financial guarantees of its affiliates and letters of credit obtained from various financial institutions. The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual amount of those obligations.

(18) Other Matters

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which contemplates continuation of the Corporation as a going concern. As of December 31, 2016 and 2015, the Corporation carried unrestricted net liabilities of \$24,891,928 and \$24,235,365, respectively. The unrestricted net liabilities are reflective of the amount due to an affiliated entity of \$24,768,163 and \$22,756,431.

As a result, the continued operations of the Corporation are dependent on continued Presbyterian Senior Living financial support and subordination of its related party debt to operating requirements and external debt repayments. Presbyterian Senior Living has agreed that the related party debt shall be subordinated to principal and interest payments on the Corporation's long-term indebtedness.

(19) Subsequent Event

Subsequent to December 31, 2016, the Corporation entered into an agreement with a financial institution to refinance the Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999A and 1999B at a fixed interest rate of 4.15% for the first five years, and then at a floating variable rate for an additional five years thereafter. The Corporation anticipates closing on this loan during the second quarter of 2017.