

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Combined Financial Statements

December 31, 2016 and 2015

(With Independent Auditor's Report Thereon)



# PRESBYTERIAN HOMES OBLIGATED GROUP

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## **Certification of Chief Executive and Chief Financial Officers**

We are responsible for the combined financial statements of the Presbyterian Homes Obligated Group 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.

Combined financial statements report our financial positions 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 combined financial statements disclose information that is important to create a complete picture of our stewardship of financial resources.

Combined 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 110 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**

The Board of Trustees  
Presbyterian Homes Obligated Group

### **Report on the Combined Financial Statements**

We have audited the accompanying combined financial statements of the Presbyterian Homes Obligated Group (the Obligated Group) which comprise the combined statements of financial position as of December 31, 2016 and 2015, and the related combined statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the combined financial statements.

### **Management's Responsibility for the Combined Financial Statements**

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined 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 combined financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of the Presbyterian Homes Obligated Group 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.

## **Basis of Combination**

We draw attention to Note 2(a) of the combined financial statements, which describes the basis of combination. The combined financial statements are prepared by the Presbyterian Homes Obligated Group to include only those entities set forth in the master trust indenture by and among BNY Mellon, dated May 1, 2008, as amended through the twenty-ninth supplemental indenture dated May 1, 2016. The consolidated financial statements of PHI, doing business as Presbyterian Senior Living, and affiliates, have been issued to its Board of Trustees as the consolidated financial statements of the primary reporting entity.

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

*Arnett Carbis Toothman LLP*

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Combined Statements of Financial Position

December 31, 2016 and 2015

<b>Assets</b>	<b>2016</b>	<b>2015</b>
Cash and cash equivalents	\$ 1,387,605	2,349,680
Investments	68,169,601	82,266,131
Statutory liquid reserves	10,187,204	10,616,069
Accounts receivable, net	23,669,105	22,776,404
Prepaid expenses and other current assets	2,765,954	3,098,618
Assets whose use is limited	8,677,793	8,634,309
Assets whose use is limited, construction funds	15,314,759	15,191,987
Pledges receivable, net	446,947	1,144,236
Property and equipment (net of accumulated depreciation of \$230,413,839 and \$220,782,978, respectively)	348,321,907	315,905,027
Assets under capital leases (net of accumulated amortization of \$947,830 and \$713,726, respectively)	356,838	414,381
Due from affiliates, net	71,221,290	64,614,509
Funds held in trust by others	17,240,286	16,994,815
Goodwill	1,836,908	1,836,908
Other assets	23,752	23,934
Total assets	<u>\$ 569,619,949</u>	<u>545,867,008</u>

See accompanying notes to combined financial statements.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Combined Statements of Financial Position

December 31, 2016 and 2015

<b>Liabilities and Net Assets</b>	<u><b>2016</b></u>	<u><b>2015</b></u>
Accounts payable	\$ 14,593,760	14,406,612
Accrued expenses	14,389,855	14,111,758
Lines of credit	14,095,665	14,845,170
Accrued interest	837,278	842,414
Resident deposits	1,214,113	3,818,037
Entrance fee payable	16,142,659	17,887,620
Deferred revenue - entrance fees	95,689,193	83,663,364
Deferred energy costs	1,202,833	-
Fair value of interest rate swap	33,034	80,945
Annuities payable	861,479	936,636
Long-term debt:		
Obligations under capital leases	379,981	449,002
Long-term debt	<u>237,739,659</u>	<u>228,733,024</u>
Total liabilities	<u>397,179,509</u>	<u>379,774,582</u>
Net assets:		
Unrestricted	148,051,580	140,779,034
Temporarily restricted	1,925,316	3,136,629
Permanently restricted	<u>22,463,544</u>	<u>22,176,763</u>
Total net assets	<u>172,440,440</u>	<u>166,092,426</u>
 Total liabilities and net assets	 <u>\$ 569,619,949</u>	 <u>545,867,008</u>

See accompanying notes to combined financial statements.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Combined Statements of Operations and Changes in Net Assets

Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating revenues, gains and other support:		
Resident services, including amortization of entrance fees of \$13,657,812 and \$13,043,760, respectively	\$ 202,058,753	185,130,290
Interest and dividend income	2,155,566	2,762,657
Realized (loss) gain on investments	(524,632)	49,107
Gain (loss) on sale of property and equipment and other assets	553,778	(19,798)
Contributions, gifts and bequests	332,132	535,941
Net assets released from restrictions	<u>2,314,669</u>	<u>2,520,767</u>
Total operating revenues, gains and other support	<u>206,890,266</u>	<u>190,978,964</u>
Expenses:		
Nursing services	53,260,841	47,889,445
Rehabilitation	13,711,336	13,027,500
Recreation and special services	5,586,828	5,066,328
Pharmacy	3,810,468	3,317,339
Social services	895,843	802,450
Physician services	662,973	548,599
Food services	22,881,311	19,987,630
Building operations and maintenance	22,438,710	19,823,716
Housekeeping	4,436,616	3,929,454
Laundry and linen	1,230,590	1,198,398
General and administrative	30,750,240	29,610,936
Employee benefits	13,398,009	11,535,824
Interest	6,458,530	6,519,370
Depreciation	17,733,907	15,359,528
Amortization	177,974	204,636
Fundraising and investment fees	<u>1,036,362</u>	<u>1,015,637</u>
Total expenses	<u>198,470,538</u>	<u>179,836,790</u>
Income from continuing operations	<u>8,419,728</u>	<u>11,142,174</u>
Discontinued operations:		
Discontinued operations, net of gain of \$8,278,206 in 2015	<u>—</u>	<u>7,962,761</u>
Gain on discontinued operations	<u>—</u>	<u>7,962,761</u>
Operating income	8,419,728	19,104,935
Change in fair value of interest rate swap	47,911	196,719
Loss on early extinguishment of debt	(123,652)	(1,867,934)
Loss on abandoned project	<u>(411,418)</u>	<u>—</u>
Excess of operating revenues, gains and other support over expenses	<u>7,932,569</u>	<u>17,433,720</u>
Other changes:		
Reserve for related party receivable	(3,000,000)	—
Unrealized gain (loss) on investments	<u>2,339,977</u>	<u>(3,084,375)</u>
Total other changes	<u>(660,023)</u>	<u>(3,084,375)</u>
Net assets, as adjusted for affiliation	<u>—</u>	<u>9,291,850</u>
Change in unrestricted net assets	<u>7,272,546</u>	<u>23,641,195</u>

See accompanying notes to combined financial statements.



**PRESBYTERIAN HOMES OBLIGATED GROUP**

Combined Statements of Operations and Changes in Net Assets

Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Temporarily restricted net assets:		
Contributions, gifts and bequests	868,058	1,482,948
Interest and dividend income	78,669	75,125
Unrealized gain (loss) on investments	156,629	(68,300)
Asset adjustment for affiliation	-	637,138
Net assets released from restrictions	<u>(2,314,669)</u>	<u>(2,520,767)</u>
Change in temporarily restricted net assets	<u>(1,211,313)</u>	<u>(393,856)</u>
Permanently restricted net assets:		
Contributions, gifts and bequests	109,371	359,340
Asset adjustment for affiliation	-	2,424,292
Change in fair value of funds held in trust by others	<u>177,410</u>	<u>(919,968)</u>
Change in permanently restricted net assets	<u>286,781</u>	<u>1,863,664</u>
Change in net assets	6,348,014	25,111,003
Net assets, beginning of year	<u>166,092,426</u>	<u>140,981,423</u>
Net assets, end of year	<u>\$ 172,440,440</u>	<u>166,092,426</u>

See accompanying notes to combined financial statements.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Combined 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 assets	\$ 6,348,014	25,111,003
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Changes in net assets resulting from affiliation	-	(12,353,280)
Depreciation	17,733,907	15,359,528
Provision for bad debt	1,013,140	2,618,536
Reserve for related party receivable	3,000,000	-
Proceeds from non-refundable entrance fees and deposits	28,157,352	26,049,530
Amortization of entrance fees	(13,657,812)	(13,043,760)
Loss on early extinguishment of debt	123,652	1,867,934
Change in fair value of interest rate swap	(47,911)	(196,719)
Unrealized (gain) loss on investments and change in fair value of funds held in trust by others	(2,674,016)	4,072,643
Realized loss (gain) on investments	524,632	(49,107)
(Gain) loss on sale of property and equipment and other assets	(553,778)	19,798
Contributions restricted for long-term purposes	(109,371)	(359,340)
Gain on discontinued operations	-	(7,962,761)
Amortization of deferred financing costs	182,088	207,872
Amortization of bond premium	(4,114)	(3,236)
Deferred energy costs adjustment	(44,167)	-
Loss on abandoned project	411,418	-
Changes in assets and liabilities:		
Increase in accounts receivable	(2,036,174)	(1,972,076)
Decrease (increase) entrance fee receivable	130,333	(682,023)
Decrease (increase) in pledges receivable	697,289	(19,588)
Decrease in other assets	332,846	574,768
Increase in accounts payable	187,148	5,111,151
Increase (decrease) in accrued expenses	272,961	(2,003,208)
Net cash provided by operating activities	<u>39,987,437</u>	<u>42,347,665</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(48,703,884)	(43,000,950)
Net proceeds from sale of property and equipment	-	10,811,282
Cash acquired in affiliation	-	84,765
Purchases of investments	(69,863,296)	(68,218,744)
Proceeds from sale of investments	86,126,348	64,143,697
Due from affiliates	(9,606,781)	(7,158,770)
Net cash used in investing activities	<u>(42,047,613)</u>	<u>(43,338,720)</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(5,077,635)	(4,628,272)
Change in entrance fee payable	(1,744,961)	(2,329,411)
Principal payments on and redemptions of long-term debt	(11,310,915)	(8,835,641)
Proceeds from issuance of long-term debt	24,540,000	77,000,000
Refunding, refinancing or payoff of long-term debt	(4,435,209)	(46,395,000)
Purchase of treasury bonds	-	(7,569,497)
Financing costs incurred	(88,867)	(539,622)
Repayments on notes payable and lines of credit	(749,505)	(5,696,132)
Borrowings through capital leases	176,561	88,313
Repayments on capital leases	(245,582)	(158,053)
Contributions restricted for long-term purposes	109,371	359,340
Decrease in annuities payable	(75,157)	(22,720)
Net cash provided by financing activities	<u>1,098,101</u>	<u>1,273,305</u>
Net (decrease) increase in cash and cash equivalents	(962,075)	282,250
Cash and cash equivalents, beginning of year	2,349,680	2,067,430
Cash and cash equivalents, end of year	<u>\$ 1,387,605</u>	<u>2,349,680</u>
Supplemental schedule of non-cash investing activities:		
Increase in property and equipment through increase in deferred energy costs	<u>\$ 1,247,000</u>	<u>-</u>
Increase in goodwill by decrease in property and equipment upon affiliation	<u>\$ -</u>	<u>1,836,908</u>

See accompanying notes to combined financial statements.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (1) General Information

The Presbyterian Homes Obligated Group (the Obligated Group) consists of the following not-for-profit corporations: Presbyterian Homes, Inc. (Pres Homes), Presbyterian Homes in the Presbytery of Huntingdon (PHPH), Quincy Retirement Community (QRC), The Long Community, Inc. (TLC), and PHI Investment Management Services, Inc. (PIMSI). In June 2015, Cathedral Village (CA) was added to the Obligated Group (Note 7). Between all the members of the Obligated Group, they own, operate and manage twelve continuing care retirement communities, three stand-alone independent living facilities, and two stand-alone personal care homes.

The Obligated Group is governed by the Board of Trustees of PHI, doing business as Presbyterian Senior Living. Presbyterian Senior Living is the parent organization for the members of the Obligated Group.

During 2015, the PHI Board of Trustees approved the sale of Woodland Retirement Community, a continuing care retirement community within PHPH. On June 1, 2015, the Obligated Group sold Woodland Retirement Community to 18889 Croghan Pike LLC.

The following table details the number of beds/units that operate under each member of the Group:

	<b>Total</b>	<b>Pres Homes</b>	<b>PHPH</b>	<b>QRC</b>	<b>TLC</b>	<b>CA</b>
Nursing beds	1,103	585	251	134	–	133
Personal care units	511	308	91	80	32	–
Independent living units	1,475	781	119	184	108	283
Total	3,089	1,674	461	398	140	416

#### (2) Summary of Significant Accounting Policies

##### (a) Basis of Combination

These combined financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, and only include those entities set forth in the master trust indenture by and among BNY Mellon, dated May 1, 2008, as amended through the twenty-ninth supplemental indenture dated May 1, 2016. Requirements of the master trust indenture preclude the consolidation of certain affiliates that are not members of the Obligated Group. All material intercompany transactions have been eliminated.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

**(b) *Basis of Accounting***

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

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) *Income Taxes***

The Obligated Group and all its members 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 Obligated Group 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 combined 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 combined financial statements.

The Obligated Group 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 combined financial statements in accordance with accounting principles generally accepted in the United States of America as set forth in the master trust indenture 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 combined financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

(e) *Cash and Cash Equivalents*

The Obligated Group considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents for the purposes of the combined statements of financial position and cash flows, except for those included in investments or assets whose use is limited. The Obligated Group's cash and cash equivalents are insured by the Federal Deposit Insurance Corporation (FDIC) for up to \$250,000. At times during 2016 and 2015, the Obligated Group's cash balances may have exceeded the FDIC coverage. The Obligated Group has not experienced any loss in these accounts.

(f) *Investments*

Investments in 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 combined statements of financial position. Alternative investments are not readily marketable and are presented at estimated fair value as determined by the investment managers. Alternative investments are held in private investment partnerships, which include publically traded securities, real estate and natural resources. Partnership agreements specify the type of investments held, liquidity, manager compensation, and other funding requirements. Management reviews, evaluates, and monitors the values provided and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Annual independent audits of each private investment partnership are provided and included in management's review.

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	\$ 2,234,235	2,837,782
Realized (loss) gain on investments	(524,632)	49,107
Unrealized gain (loss) on investments and funds held in trust by others	<u>2,674,016</u>	<u>(4,072,643)</u>
	<u>\$ 4,383,619</u>	<u>(1,185,754)</u>

Investment expenses of \$488,148 and \$427,210 for the years ended December 31, 2016 and 2015, respectively, have been included in fundraising and investment fees on the combined statements of operations and changes in net assets.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined 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:

	<b>2016</b>	<b>2015</b>
Total accounts receivable	\$ 26,109,612	27,012,877
Less: allowance for doubtful accounts	(2,440,507)	(4,236,473)
Net accounts receivable	\$ 23,669,105	22,776,404

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 \$1,054,392.

**(h) *Assets Whose Use is Limited***

Assets whose use is limited primarily include assets held by a trustee under the terms of various bond indentures and permanently restricted investments.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(i) Pledges Receivable**

The Obligated Group records material pledges due in more than one year at the net present value less a discounted uncollectable amount.

	<u>2016</u>	<u>2015</u>
Pledges receivable	\$ 497,598	1,209,170
Less: unamortized discount	<u>(22,707)</u>	<u>(22,707)</u>
Subtotal	474,891	1,186,463
Less: allowance for uncollectables	<u>(27,944)</u>	<u>(42,227)</u>
Net pledges receivable	\$ <u><u>446,947</u></u>	<u><u>1,144,236</u></u>

Pledges receivable as of December 31, 2016, are due as follows:

Amounts due in:	
Less than one year	\$ 197,972
One to five years	<u>299,626</u>
	\$ <u><u>497,598</u></u>

**(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 Obligated Group'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	3-35 years
Buildings and improvements	5-75 years
Departmental equipment, furniture and fixtures	1-40 years
Furniture	5-25 years
Vehicles	4 years

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

**(k) *Costs of Borrowing***

The average cost of capital during the period of construction of capital assets is capitalized as a component of construction-in-progress. Interest of \$905,955 and \$898,730 was capitalized in 2016 and 2015, respectively.

**(l) *Funds Held in Trust by Others***

The members of the Obligated Group have been named as a beneficiary of several trusts which are administered and controlled by independent trustees. The trusts are recorded as contribution revenue when the Obligated Group is notified of the trust's existence. The Obligated Group receives the earnings from these trusts whose principal is to be held in perpetuity. The earnings from the trust are reported as investment income, increasing unrestricted net assets.

Assets held in trust by others are valued based on the estimated fair value of the underlying investments. The change in the fair value of assets held in trust by others is reported as permanently restricted unrealized gains or losses on investments.

Also included in funds held in trust by others are gift annuities held by an independent trustee. Periodic payments are made until the death of the annuitant. These annuities are recorded at the present value of the annuity amount discounted at the contract rate over the estimated remaining life of the annuitant.

A summary of these funds as of December 31 is as follows:

	<u>2016</u>	<u>2015</u>
Beneficial interest in perpetual trusts	\$ 16,506,469	16,327,200
Contributions receivable from remainder trusts	718,301	652,092
Gift annuities	<u>15,516</u>	<u>15,523</u>
	<u>\$ 17,240,286</u>	<u>16,994,815</u>

**(m) *Derivatives and Hedging Activities***

The Obligated Group utilizes interest rate swap agreements to hedge variable interest rates but elected not to elect hedge accounting for these agreements.

The Obligated Group's interest rate swaps are carried as a liability as determined by a third party. Changes in fair value are reported on the combined statements of operations and changes in net assets as a component of the excess of operating revenues, gains and other support over expenses. For 2016 and 2015, an adjustment to the liability was recorded causing a gain for each year of \$47,911 and \$196,719, respectively. These adjustments represent the decrease in the liability of the interest rate swaps.



## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

**(n) *Deferred Financing Costs***

The Obligated Group has deferred the costs incurred for obtaining the proceeds of its long-term debt arrangements. These costs are being amortized over the term of the related financings using the straight-line method which approximates the effective interest method. The Obligated Group incurred financing costs of \$88,867 and \$539,622 during the years ended December 31, 2016 and 2015, respectively. The Obligated Group refunded \$123,652 and \$774,634 in financing costs, which is included in loss on early extinguishment of debt for the years ended December 31, 2016 and 2015, respectively. Amortization expense is expected to be \$178,237, \$172,271, \$149,487, \$141,016 and \$111,955 for the next five years, respectively. 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 Obligated Group adopted this guidance during the year ended December 31, 2016 (Note 8).

**(o) *Workers' Compensation***

Accrued expenses include a provision for estimated self-insured workers' compensation claims for both reported claims not yet paid and claims incurred but not reported.

**(p) *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 combined statements of financial position. These deposits are transferred to deferred revenue upon occupancy of the related units. Entrance fee deposits received prior to occupancy for newly constructed independent units are held in a separate interest bearing escrow account and amounted to \$68,500 as of December 31, 2016. The escrow account is included in cash and cash equivalents on the combined statement of financial position.

**(q) *Deferred Revenue – Entrance Fees***

The Obligated Group follows the FASB accounting standards update regarding refundable entrance fees. This standard was issued to clarify the reporting for refundable advanced fees received by continuing care retirement communities. This guidance clarifies that an entity should classify an advance fee as deferred revenue when a continuing care retirement community has a resident contract that provides for payment of the refundable advanced fee upon reoccupancy by a subsequent resident, which is limited to the proceeds of reoccupancy. Refundable advance fees that are contingent upon reoccupancy by a subsequent resident but are not limited to the proceeds of reoccupancy should be accounted for and reported as a liability.

The Obligated Group does not amortize the guaranteed refundable portion of the entrance fees. This portion of the entrance fee is reflected as a liability on the combined statements of financial position. The amount of entrance fees guaranteed refundable to residents as of December 31, 2016 and 2015, under contractual refund provisions was \$16,142,659 and \$17,887,620, respectively.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

(r) ***Obligation to Provide Future Service***

The Obligated Group periodically calculates the present value of the net cost of future services and the use of facilities to be provided to current residents and compares that with the balance of deferred revenue - entrance fees. If the present value of the net cost of future services and the use of facilities exceeds deferred revenue - entrance fees, a liability is recorded with the corresponding change to income. As a result of the calculation using a discount rate of 5.5%, the present value of the net cost of future services and use of facilities did not exceed deferred revenue - entrance fees; accordingly, no obligation was recorded as of December 31, 2016 or 2015.

(s) ***Goodwill***

Goodwill represents the excess of appraised value over the book value of the assets of Cathedral Village at the time of the affiliation. Goodwill is reviewed annually for impairment or more frequently if events or circumstances indicate that the carrying value of the goodwill may not be recoverable. The Obligated Group qualitatively assesses goodwill for impairment prior to completing a quantitative analysis of potential goodwill impairment. Under the qualitative approach, the Obligated Group assesses the likelihood that the fair value is greater than the carrying value. If the Obligated Group determines that it is more likely than not that the fair value is greater than the carrying value, then the quantitative analysis is not required. No impairment was recognized in the years ended December 31, 2016 and 2015, as the Obligated Group concluded it was more likely than not that the fair value exceeded the carrying value.

(t) ***Statutory Liquid Reserves***

The Continuing Care Provider Registration and Disclosure Act in Pennsylvania requires a working capital reserve equivalent to the greater of the total debt service payments due during the next 12 months on account of any loan or long-term financing, or 10% of the projected annual operating expenses of the Obligated Group exclusive of depreciation. The reserve is computed on only the proportional share of financing or operating expenses that are applicable to Residence and Care Agreements.

In addition to the statutory liquid reserves, deposit and entrance fee payments of approximately \$1,200,000 received by the Obligated Group prior to the date the resident occupies the living unit are also included in the required statutory liquid reserves and cash and cash equivalents on the accompanying combined statements of financial position.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

**(u) *Deferred Energy Costs***

In October 2014, Cathedral Village entered into an agreement to improve the efficiency and reduce the cost of its electric utility service by installing gas-fired turbines and associated equipment to provide electricity and hot water to a portion of Cathedral Village's facilities. The project was complete on April 15, 2016. Upon completion of the project, the equipment was transferred to Cathedral Village and Cathedral Village was then responsible to pay minimum quarterly payments of \$94,322, increasing 1.3% on each contract anniversary date for twenty years, expiring in 2035. The amount of equipment transferred to Cathedral Village totaled \$1,247,000 and is included in property and equipment. A corresponding long-term deferred energy cost was also recorded. The deferred energy cost is being amortized over the life of the agreement and is included in building operations and maintenance expense.

**(v) *Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Obligated Group has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Obligated Group in perpetuity. The interest and dividend income from these restricted assets is used for the charitable purpose.

**(w) *Donor Restrictions***

The Obligated Group 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 combined statements of operations and changes in net assets 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 combined financial statements.

The Obligated Group 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 Obligated Group reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Contributions, including unconditional promises to give, are recognized as revenues when the promise to give is first made. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value as of the date of contribution.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

(x) ***Resident Service Revenue and Business Concentration***

Resident service revenue is reported at the estimated net realizable amount to be received from patients and others including Medicare, Medicaid, and other third-party payors for services rendered. The Obligated Group derives a portion of its revenues from federal and state reimbursement programs with a significant portion of state reimbursement from Pennsylvania's Department of Human Services (DHS).

The Obligated Group's nursing care facilities primarily derive their revenue from private pay, Medicare, and Medicaid. Private pay rates are established on the basis of the cost of delivering services and competitive consideration and, as such, are essentially market driven. In contrast, Medicare and Medicaid payment rates are regulated by the federal and state governments. As a result, the industry is sensitive to related legislative changes and is affected by reductions in governmental spending for these programs.

Revenues from Medicare and Medicaid represent approximately 40% and 39% of revenues for 2016 and 2015, respectively. Medicare and Medicaid receivables represent approximately 42% and 43% of accounts receivable as of December 31, 2016 and 2015, respectively.

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

Nursing services provided to Pennsylvania 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 Obligated Group's current concentration of skilled nursing facilities in Pennsylvania exposes it to the risk of changes in Medicaid reimbursement in this state. Rates are calculated by DHS on a quarterly basis. They are published in the Pennsylvania Bulletin prior to being finalized. As of December 31, 2016, the rates for July 1, 2016, through December 31, 2016, have not been finalized. Revenues have been accrued based on proposed rates for these periods.

In January 2005, the Centers for Medicare and Medicaid Services (CMS) approved a Pennsylvania State Plan amendment implementing a Nursing Home Assessment (the Assessment). The Assessment requires all Pennsylvania nursing homes, except for county homes, to pay a fee to DHS based upon all non-Medicare days. DHS makes supplemental payments back to nursing home facilities, based upon a standard rate per Medicaid day claimed. The supplemental and assessment amounts per day have been approved by CMS. For the years ended December 31, 2016 and 2015, the Obligated Group received or will receive approximately \$2,000,000 and \$2,100,000, respectively, in additional revenue for the net effect of this assessment and supplement.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

(y) ***Charity Care***

The Obligated Group follows the FASB accounting standards update that provides improved disclosure about charity care. The amount of charity care disclosed on the combined financial statements is measured based on the direct and indirect costs of providing charity care services. If the costs cannot be specifically attributed to services provided to charity care patients, reasonable techniques are used to estimate these costs, and these techniques are disclosed. Any funds received to offset or subsidize charity care services are also disclosed.

The Obligated Group'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 Obligated Group also receives donations and income from permanently restricted trusts and investments designated to the needs of its residents under this policy.

Amounts the Obligated Group 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	\$ 5,144,447	4,271,977
Additional benevolent care provided at amounts less than pre-established charges for private pay services	28,032,155	24,760,075
Giving and income designated for resident financial support	1,032,146	957,136

(z) ***Advertising***

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2016 and 2015, was \$502,446 and \$484,426, respectively.

(aa) ***Classification of Expenses***

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

	<u>2016</u>	<u>2015</u>
Program activities	\$ 166,683,936	150,225,854
General and administrative	31,238,388	29,022,509
Fundraising	548,214	588,427
	<u>\$ 198,470,538</u>	<u>179,836,790</u>

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

**(ab) Fundraising Expenses**

Fundraising expenses incurred by the Obligated Group are included in fundraising and investment fees on the combined statements of operations and changes in net assets.

**(ac) Operating Income**

The combined statements of operations and changes in net assets include an intermediate measure of operations labeled as “operating income.” Changes in the performance indicator which are excluded from this measure include change in fair value of interest rate swap, loss on early extinguishment of debt, and loss on abandoned project.

**(ad) Performance Indicator**

The Obligated Group measures the performance of its operations using the combined statements of operations and changes in net assets, which includes a performance indicator of operations labeled as “excess of operating revenues, gains, and other support over expenses.” Changes in unrestricted net assets which are excluded from this measure are: reserve for related party receivable, unrealized gain (loss) on investments, and net assets, as adjusted for affiliation.

**(ae) Combined Statements of Cash Flows**

Interest paid during the years ended December 31, 2016 and 2015, was \$7,369,621 and \$7,205,353, respectively.

**(af) Reclassifications**

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

**(ag) Subsequent Events**

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

The Obligated Group has evaluated subsequent events through April 7, 2017, which is the date the combined financial statements were issued.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(3) Investments**

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

	2016		2015	
	Fair value	Cost	Fair value	Cost
Money market funds	\$ 25,400,722	25,400,722	33,622,259	33,622,259
Marketable equity securities	2,165,520	1,708,969	2,046,681	1,630,085
Equity securities	28,133,540	26,086,916	41,854,295	40,593,789
Fixed income securities	18,404,310	18,296,655	14,631,289	15,112,094
Alternative investments	28,245,265	19,103,291	24,553,972	16,499,068
Totals	102,349,357	\$ 90,596,553	116,708,496	\$ 107,457,295
Less:				
Assets whose use is				
limited (Note 5)	(23,992,552)		(23,826,296)	
Statutory liquid reserves	(10,187,204)		(10,616,069)	
Total investments	\$ 68,169,601		82,266,131	

The Obligated Group invests primarily in a diversified portfolio of mutual funds. The Obligated Group had forty-five mutual funds, eight alternative investments, sixty-nine stocks and several other fixed income securities as of December 31, 2016. The Obligated Group had forty-five mutual funds, eight alternative investments, sixty-three stocks and several other fixed income securities as of December 31, 2015.

As of December 31, 2016, twelve mutual funds and nine stocks had a market value that had been below cost for less than a year. In total, its market value was less than three percent below cost. As of December 31, 2015, twenty-seven mutual funds and nineteen stocks had a market value that had been below cost for less than a year. In total, its market value was eight percent below cost.

Nineteen mutual funds and two stocks had a market value that had been below cost for more than a year as of December 31, 2016. In total, its market value was less than five percent below cost. Eleven mutual funds had a market value that had been below cost for more than a year as of December 31, 2015. In total, its market value was three percent below cost.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (3) Investments (continued)

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

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	\$ 11,395,443	(279,981)	12,393,106	(583,294)	23,788,549	(863,275)
Equity securities	214,668	(16,997)	77,158	(3,779)	291,826	(20,776)
Total temporarily impaired investments	\$ 11,610,111	(296,978)	12,470,264	(587,073)	24,080,375	(884,051)

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

	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
Mutual funds	\$ 28,591,428	(2,455,426)	6,763,155	(224,560)	35,354,583	(2,679,986)
Equity securities	517,115	(44,048)	-	-	517,115	(44,048)
Total temporarily impaired investments	\$ 29,108,543	(2,499,474)	6,763,155	(224,560)	35,871,698	(2,724,034)

#### (4) Related Party Transactions

The Obligated Group members incur a management fee payable to their parent organization under a management agreement whereby Presbyterian Senior Living provides the Obligated Group with various management and administrative services to each of the Obligated Group's operating facilities. The Obligated Group members also incur certain operating expenses under the management agreement that are comprised primarily of the salaries and benefits of certain key management personnel provided to the Obligated Group by the parent organization. During the years ended December 31, 2016 and 2015, the Obligated Group incurred management fees and other expenses under the management agreement totaling \$15,815,544 and \$14,942,317, respectively, which is included in general and administrative expenses and discontinued operations on the combined statements of operations and changes in net assets.

The Obligated Group is an irrevocable guarantor of all the debts of Presbyterian Senior Living Services, Inc. (Glen Meadows), an affiliate organization. As of December 31, 2016 and 2015, Glen Meadows had \$13,855,000 and \$14,505,000, respectively, in outstanding debt. In the event of a deficiency judgment from the sale of real property pledged as security for the purchase of a facility in Glen Arm, Maryland, the Obligated Group has guaranteed to repay all of the outstanding debt which matures through 2029.



## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (4) Related Party Transactions (continued)

The Obligated Group is an irrevocable guarantor of the Metro Bank Loan for PHI Stadium Place Senior Care, Inc., an affiliate organization, for a maximum principal amount of \$10,000,000. As of December 31, 2016 and 2015, PHI Stadium Place Senior Care, Inc. had \$9,237,592 and \$9,434,871, respectively, in outstanding debt. In the event of a deficiency judgment, the Obligated Group has guaranteed to repay all of this outstanding debt which matures through 2034.

Prelude Systems, Inc. (Prelude) is a joint venture between Presbyterian Senior Living and Diakon Lutheran Social Ministries (Diakon). Prelude is a technical information services organization with a wide range of programs designed to support the information systems needs of both Presbyterian Senior Living and Diakon as well as other health care and community service organizations. During 2016 and 2015, the Obligated Group incurred expenses related to Prelude amounting to \$1,909,057 and \$1,795,380, respectively, for information services provided by Prelude, of which \$24,192 and \$42,134 is included in accounts payable as of December 31, 2016 and 2015, respectively.

Amounts due from affiliate entities, principally Presbyterian Senior Living, as of December 31, 2016 and 2015, are \$71,221,290 and \$64,614,509, respectively.

During 2016, Ware Presbyterian Village transferred 3.1 acres of land to Westminster Place at Ware Presbyterian Village. The land was transferred at fair market value, causing the Obligated Group to recognize a realized gain on sale of assets of \$970,000, which is included in gain on sale of property and equipment on the combined statement of operations and changes in net assets.

The amounts receivable from the Obligated Group's affiliated organizations are unsecured, non-interest bearing and have no fixed repayment terms, except loans to the low income housing corporations. In 2016, the Obligated Group increased the established reserve of \$10,000,000 to \$13,000,000 based on management's assessment of the collectability of specific receivables from an affiliate organization. The provision of \$3,000,000 for the year ended December 31, 2016, is included in other changes in unrestricted net assets on the combined statements of operations and changes in net assets.

#### (5) Assets Whose Use is Limited

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

	<u>2016</u>	<u>2015</u>
Permanently restricted investments	\$ 4,892,618	4,783,247
Bond fund	1,361,478	1,092,119
Debt service reserve fund	2,423,697	2,758,943
Held by trustee for future projects	15,314,759	15,191,987
	<u>\$ 23,992,552</u>	<u>23,826,296</u>

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(6) 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	\$ 42,434,262	–	38,428,468	–
Land improvements	18,838,759	15,271,453	18,355,312	14,878,627
Buildings and improvements	426,056,336	176,407,929	382,910,341	166,809,826
Departmental equipment, furniture and fixtures	46,641,709	37,194,904	45,536,492	37,341,521
Vehicles	1,664,520	1,539,553	1,912,399	1,753,004
Construction-in-progress	43,100,160	–	49,544,993	–
	\$ 578,735,746	230,413,839	536,688,005	220,782,978
Net book value		\$ 348,321,907		\$ 315,905,027

As the Obligated Group undertakes expansion and improvement projects, costs are included in construction-in-progress. As projects are completed, the costs are transferred to buildings and building improvements. Ongoing improvement and expansion is anticipated in the normal course of operations.

As of December 31, 2016 and 2015, approximately \$3,700,000 and \$24,700,000, respectively, was committed for future renovations.

On June 1, 2015, the Obligated Group sold Woodland Retirement Community for approximately \$10,811,000, and recognized a gain of \$7,962,761.

For the year ended December 31, 2015, Woodland Retirement Community's gain consisted of:

	2015
Depreciation	\$ (134,760)
Interest	(15,880)
Amortization	(2,940)
Other income, net of gain of \$8,278,206 in 2015	8,116,341
Total gain on discontinued operations	\$ 7,962,761

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (7) Affiliation

On June 1, 2015, with the consent of the Board of Directors of Cathedral Village, Cathedral Village affiliated with PHI d/b/a Presbyterian Senior Living (PSL) and the Presbyterian Homes Obligated Group. The Obligated Group elected to account for the affiliation using the pushdown method of accounting, whereby Cathedral Village's property and equipment were adjusted to fair value based on an appraisal.

The following is a summary of the identifiable and intangible assets on the affiliation date:

Land and land improvements	\$ 10,504,338
Buildings and improvements	18,177,654
Furniture and equipment	1,081,100
Goodwill	<u>1,836,908</u>
Fair value of identifiable and intangible assets	<u>\$ 31,600,000</u>

Goodwill represents the intangible assets associated with Cathedral Village and includes the right to use the name Cathedral Village, value of occupied beds at the Community, medical records, staff of Cathedral Village, reputation in the community, 133 skilled nursing bed licenses, and any other intangibles of the business.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (7) Affiliation (continued)

The following are the amounts recognized by the Obligated Group on the affiliation date, for each major class of assets and liabilities as a result of required not-for-profit accounting principles related to affiliations:

##### Assets

Cash and operating investments	\$	740,588
Accounts and pledges receivable, net		1,172,303
Prepaid expenses and other current assets		554,871
Investments and assets whose use is limited		13,263,133
Property and equipment		31,600,000
Deferred financing costs, net		475,847
Beneficial interest in perpetual trusts		<u>2,419,343</u>
Total assets		<u>50,226,085</u>

##### Liabilities

Accounts payable		216,906
Accrued expenses		3,248,610
Refundable deposits from prospective residents		1,106,249
Long-term debt		14,053,937
Deferred revenue from advanced fees		<u>19,247,103</u>
Total liabilities		<u>37,872,805</u>
Gain recognized	\$	<u><u>12,353,280</u></u>

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(8) Long-term Debt**

Long-term debt of the group and of the amounts payable by the Obligated Group as of December 31 consisted of the following:

	<b>2016</b>	<b>2015</b>
1995 Series A Revenue Note to First National Bank, payable in equal monthly installments of principal and interest, interest sufficient to amortize the principal balance to July 2026, the note bears a floating interest rate which was 2.05% as of December 31, 2016 and 2015, interest will be reset in three year increments	\$ 1,585,305	1,759,820
Series 2002 Huntingdon County Industrial Development Authority, Mortgage Revenue Note, payable to First National Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to April 2023, the note bears a floating interest rate, interest will be reset in five year increments and was 1.76% as of December 31, 2016 and 2015	366,827	419,285
Cumberland County Municipal Authority Revenue Bonds Series 2003B, variable rate bonds, held by First National Bank, principal maturities in varying amounts from 2016 to 2032, interest converted to a fixed rate of 3.8% on January 2, 2015	6,590,000	6,885,000
Kent County Delaware Economic Development Revenue Bond Series 2003B, held by Bank of America, principal and interest payable monthly on a 15-year amortization period, the final principal payment due October 31, 2018, variable interest of 1.35% and 0.99% as of December 31, 2016 and 2015, respectively	1,614,039	2,345,544
Philadelphia Authority for Industrial Development Gross Revenue Bonds, Series 2003A, principal maturities due in varying amounts from 2003 to 2034, the bonds consist of term bonds which will mature on April 1, 2023, at a fixed interest rate of 6.25% and on April 1, 2034, at a fixed rate of 6.875%	–	405,000
Philadelphia Authority for Industrial Development Gross Revenue Bonds, Series 2003B, principal maturities due in varying amounts from 2003 to 2034, the bonds bear a floating interest rate, interest will be reset in five year increments and was 5.50% as of December 31, 2015	–	230,000

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(8) Long-term Debt (continued)**

	<b>2016</b>	<b>2015</b>
Series 2005 College Township Revenue Bonds, held by First National Bank, payable in equal installments to include principal and interest through September 2026, the bonds bear a floating interest rate, which will reset in five year increments and were 3.67% and 3.83% as of December 31, 2016 and 2015, respectively	2,267,450	2,455,176
Cumberland County Municipal Authority Revenue Bonds Series 2008A, principal due in varying annual amounts from 2015 to 2021, interest rates ranging from 4% to 5.45%	4,190,000	5,455,000
Cumberland County Municipal Authority Revenue Bonds Series 2013A, held by Key Bank, principal due in varying annual amounts from 2015 to 2026, interest is fixed at 3.11%, interest will be reset in ten year increments	6,475,790	6,500,790
Cumberland County Municipal Authority Revenue Bonds Series 2008C, variable rate bonds, converted to fixed rate bonds in 2013, principal maturities in varying amounts from 2015 to 2026, interest rates ranging from 3.82% to 4%	14,485,000	14,730,000
York County Industrial Development Authority Bonds Series 2010, held by First National Bank, principal due in varying annual amounts from 2013 to 2033, the bonds bear a floating interest rate, which resets in five year increments, and was 2.75% as of December 31, 2016 and 2015	17,324,552	18,066,102
Bank of America taxable ten year term loan, principal due in varying amounts, extended in 2016 to be due in December 2026 with the option to extend all or a portion of the remaining balance over the remaining 25-year amortization period. The bonds bear a floating interest rate which resets in five year increments, and was 3.85% and 3.13% as of December 31, 2016 and 2015, respectively	11,192,409	11,550,340
General Municipal Authority of the Township of Manheim Revenue Bonds Series 2011, held by M&T Bank, principal maturities based on a twenty year repayment schedule, interest is fixed for the first 120 months, subsequent interest rates will be reset in ten year increments, interest was 3.48% as of December 31, 2016 and 2015	8,112,544	8,512,486

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(8) Long-term Debt (continued)**

	<u>2016</u>	<u>2015</u>
Quincy Sewer Authority Revenue Bonds Series 2012, held by M&T Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to August 15, 2032, interest is fixed at 3.35% until 2022, subsequent interest rates will be reset in ten year increments	8,366,919	8,761,419
Uwchlan Township Industrial Development Authority Revenue Note Series 2012, held by First National Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to June 2032, interest is fixed at 3.5% until June 2022, interest rates will be reset in ten year increments	8,325,485	8,720,498
General Municipal Authority of the Township of Manheim Bond Series 2012, held by BB&T Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to September 2032, a call option is available at the lender's discretion in August 2022, interest is fixed at 2.75%, interest will be in 7 year increments	8,306,378	8,720,091
Cumberland County Municipal Authority Revenue Bonds Series 2013B, held by Key Bank, principal due in varying annual amounts from 2013 to 2022, interest is fixed at 3.11% as of December 31, 2016 and 2015	4,250,886	4,475,886
Uwchlan Township Industrial Development Authority Revenue Bonds Series 2013, held by M&T Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to June 2033, interest is fixed at 3.6% until June 2023, interest rates will be reset in ten year increments	8,769,264	9,142,942
Indiana County Industrial Development Authority Revenue Bonds Series 2013, held by BB&T Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to November 15, 2033, interest is fixed at 3.48% until 2020, interest rates will be reset in seven year increments	8,878,888	9,254,375

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(8) Long-term Debt (continued)**

	<b>2016</b>	<b>2015</b>
Philadelphia Authority for Industrial Development Gross Revenue Bonds, Series 2013, no principal payment due until April 2017, the bonds consist of term bonds which mature at various dates from April 2023 to April 2039, interest is fixed at 4.81%	2,635,000	2,635,000
First National Bank taxable fifteen year term loan, principal and interest is payable in equal quarterly installments of \$99,063 through maturity in April 2029, interest is fixed at 4.80%	–	3,903,686
Northampton and Blair County Industrial Development Authority Revenue Bonds Series 2014, held by Bank of America, principal due in varying amounts annually, interest is fixed at 3.24% until June 2024, interest will be reset in ten year increments	9,832,500	9,899,500
Blair County Hospital Authority Revenue Bonds Series 2014, tax exempt bonds, bank qualified debt, held by Bank of America, principal due in varying amounts annually, interest is fixed at 3.24% until June 2024, interest will be reset in ten year increments	9,832,500	9,899,500
Uwchlan Township Industrial Development Authority Revenue Bonds Series 2015, held by M&T Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to May 2035, interest is fixed at 2.92% until May 2025, interest rates will be reset in ten year increments	9,407,118	9,782,480
Northampton County Industrial Development Authority Revenue Bonds Series 2015, held by M&T Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to May 2035, interest is fixed at 2.80% until May 2025, interest rates will be reset in ten year increments	9,443,923	9,822,770
People's Bank taxable ten year term loan, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to July 31, 2025, interest is variable and was 2.63% and 2.25% as of December 31, 2016 and 2015, respectively	5,273,304	5,819,138



**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(8) Long-term Debt (continued)**

	<u>2016</u>	<u>2015</u>
First National Bank taxable ten year term loan, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to July 31, 2025, interest is variable and was 2.87% and 2.34% as of December 31, 2016 and 2015, respectively	5,288,549	5,822,120
Abington Township Industrial and Commercial Development Authority Revenue Bonds, Series 2015, held by First National Bank, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to September 2035, interest is variable and was 2.35% as of December 31, 2016 and 2015, interest rates will be reset in five year increments	9,540,239	9,936,269
Cumberland County Municipal Authority Revenue Bonds Series 2015A, held by Bank of America, principal due in varying monthly amounts through maturity in December 2021, interest is fixed at 2.28%	8,214,250	9,747,789
Cumberland County Municipal Authority Revenue Bonds Series 2015B, held by Bank of America, principal due in varying annual amounts from 2015 to 2038, interest is fixed at 2.99% until 2025, interest rates will be reset in ten year increments	9,682,814	10,000,000
Cumberland County Municipal Authority Revenue Bonds Series 2015 C and Series 2008 C, held by Bank of America, principal due in varying amounts from 2015 to 2038, interest is variable and was 1.72% and 1.47 % as of December 31, 2016 and 2015, respectively	14,721,333	14,955,333
Quincy Sewer Authority Series 2016 bonds held by TD Bank, principal due in varying annual amounts from 2017 to 2042, interest is fixed at 2.40% until 2021, interest rates will be reset in five year increments	20,000,000	—

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(8) Long-term Debt (continued)**

	<b>2016</b>	<b>2015</b>
Bank of America taxable ten year term loan, principal due in varying amounts through 2034, due in May 2026 with the option to extend all or a portion of the remaining balance over the remaining 25-year amortization period. The bonds bear a floating interest rate which was 2.32% as of December 31, 2016	4,433,949	—
	239,407,215	230,613,339
Plus: Unamortized premium	74,013	78,127
Less: Deferred financing costs	(1,741,569)	(1,958,442)
	\$ 237,739,659	228,733,024

All of the Obligated Group long-term debt is collateralized by property and equipment and gross revenues of the Obligated Group and is tax exempt, unless otherwise stated.

Under the terms of the Obligated Group's debt, the Obligated Group is required to maintain certain measures of financial performance as long as the notes are outstanding. These covenants have been met as of December 31, 2016 and 2015.

In 2016, the Obligated Group refunded and replaced the Philadelphia Authority for Industrial Development Series 2003A and 2003B Bonds, together with The First National Bank 15 year term loan. A loss on the extinguishment of debt in the amount of \$123,652 was recorded in 2016, representing the write-off of the unamortized debt issuance costs on this debt.

In 2015, the Obligated Group refunded and replaced the Cumberland County 1993A, 2005A and 2008B Bonds and the Montgomery County 1997 and 2008A Bonds and acquired a portion of the Philadelphia 2013 Bonds. A loss on the extinguishment of debt in the amount of \$1,867,934 was recorded in 2015, representing the write-off of the unamortized debt issuance costs, discount and premium on the original purchase.

During 2014, \$10,000 of the Cumberland County 2005A Bonds that were previously repurchased were sold. In 2015, the remaining \$30,000 of the Cumberland County 2005A Bonds were sold. In 2015, \$6,540,000 of the Philadelphia Authority for Industrial Development Gross Revenue Bonds Series 2013 Bonds were purchased and are being held with the option to remarket at a future date.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(8) Long-term Debt (continued)**

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

<u>Years ended December 31,</u>	<u>Aggregate maturities</u>
2017	\$ 12,230,998
2018	12,748,780
2019	12,537,437
2020	12,526,324
2021	14,381,573
Thereafter	174,982,103
	<u>\$ 239,407,215</u>

The Obligated Group entered into a swap agreement with Bank of America, which fixes the interest rate to be paid by the Obligated Group on the Kent County 2003B Bonds as follows:

<u>Amount Swapped</u>	<u>Basis</u>	<u>Counterparty</u>	<u>Effective Date</u>	<u>Expiration Date</u>	<u>Interest Rate</u>	<u>Underlying Issue</u>
\$1,610,439	LIBOR	Bank of America	11/28/08	10/31/18	3.73%	Kent County 2003B

The fair value of the interest rate swap liability as of December 31 is as follows:

<u>Counterparty</u>	<u>Fair Value 12/31/2016</u>	<u>Fair Value 12/31/2015</u>
Bank of America	\$ 33,034	\$ 80,945

Pursuant to all these agreements the counterparty assumes 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 Obligated Group.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (9) Lines of Credit

The Obligated Group has lines of credit with Bank of America and M&T Bank. Interest rates on these lines of credit are variable. The lines of credit are collateralized by property, plant and equipment of the Obligated Group. As of December 31, 2016 and 2015, under the line of credit agreements, the Obligated Group had available a total maximum of \$16,750,000 from the financial institutions. As of December 31, 2016 and 2015, the Obligated Group had \$14,095,665 and \$14,845,170, respectively, outstanding under these agreements at interest rates ranging from 0.25% to 3.38%.

#### (10) Leases

The Obligated Group is obligated under capital leases for equipment and vehicles that expire in 2020, with interest rates ranging from 2.5% to 5.0%. As of December 31 the gross amounts of the equipment and related accumulated amortization recorded under capital leases were as follows:

	<u>2016</u>	<u>2015</u>
Office equipment and vehicles	\$ 1,304,668	1,128,107
Accumulated amortization	<u>(947,830)</u>	<u>(713,726)</u>
	<u>\$ 356,838</u>	<u>414,381</u>

Amortization expense of \$234,104 and \$218,014 for the years ended December 31, 2016 and 2015, respectively, for the assets held under capital leases is included in depreciation expense on the combined statements of operations and changes in net assets.

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

2017	\$ 215,062
2018	116,410
2019	57,197
2020	<u>2,200</u>
	390,869
Amounts representing interest	<u>(10,888)</u>
	<u>\$ 379,981</u>

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (10) Leases (continued)

The Obligated Group leases certain equipment under operating leases, which expire at various dates through 2019. The future minimum lease payments under these operating leases are as follows as of December 31, 2016:

2017	\$	158,650
2018		84,338
2019		<u>11,840</u>
	\$	<u>254,828</u>

Rental expense under operating leases was \$634,414 and \$542,534 for the years ended December 31, 2016 and 2015, respectively.

#### (11) Annuities

The Obligated Group 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 Obligated Group. Total annuities payable were \$861,479 and \$936,636 as of December 31, 2016 and 2015, respectively. The Obligated Group uses published mortality-rate tables adopted by the United States Internal Revenue Service and an assumed discount rate of approximately 4 to 6 percent to determine the present value of the actuarially determined liability. The Obligated Group has assets included in investments of \$1,408,411 and \$1,418,411 as of December 31, 2016 and 2015, respectively, to satisfy annuities.

#### (12) Workers' Compensation Insurance

The Obligated Group has instituted a self-insured workers' compensation program as allowed by the Commonwealth of Pennsylvania Bureau of Workers' Compensation. This program provides for self-payment of work related injuries and illnesses as opposed to utilizing an insurance carrier. The Obligated Group has contracted with major insurance carriers for excess insurance coverage, loss control services, and administration. For both 2016 and 2015, the Obligated Group maintained a surety bond for \$3,000,000, in connection with this self-insurance program. As of December 31, 2016 and 2015, the Obligated Group has recorded an accrued expense of approximately \$4.1 million and \$4.0 million, respectively, for workers' compensation claims which includes known case reserves and an estimate of the Obligated Group's liability for incurred but not reported claims.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (13) Medical Malpractice Claims Coverage

The Obligated Group 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 Obligated Group's insurance coverages or will have a material adverse effect on the combined financial statements.

#### (14) Temporarily Restricted Net Assets

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

	<u>2016</u>	<u>2015</u>
Charity care and/or equipment, including pledges receivable		
Endowment	\$ 305,767	1,296,336
Other	1,120,107	1,408,909
Gift annuities	359	366
Contributions receivable from remainder trusts	<u>499,083</u>	<u>431,018</u>
	<u>\$ 1,925,316</u>	<u>3,136,629</u>

Net assets of \$2,314,669 and \$2,520,767 were released from restriction during 2016 and 2015, respectively, in satisfaction of the above restrictions.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (15) Permanently Restricted Net Assets

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

	<u>2016</u>	<u>2015</u>
Trust assets held for the benefit of The Easton Home	\$ 830,086	830,086
Investments to be held in perpetuity, the income from which is expendable to support the following endowments:		
Operations	2,136,346	2,091,355
Scholarships	32,088	23,456
Charity care and/or equipment	2,724,181	2,668,436
Contributions receivable from remainder trusts	219,218	221,075
Gift annuities	15,156	15,155
Beneficial interest in perpetual trusts	<u>16,506,469</u>	<u>16,327,200</u>
	<u>\$ 22,463,544</u>	<u>22,176,763</u>

#### (16) Endowments

The endowments consist of donor restricted funds established for a variety of purposes supporting the Obligated Group. 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.

## PRESBYTERIAN HOMES OBLIGATED GROUP

Notes to Combined Financial Statements

December 31, 2016 and 2015

### (16) Endowments (continued)

#### Interpretation of Relevant Law

The Board of Trustees of the Obligated Group 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 Obligated Group 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 Obligated Group 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 Obligated Group 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 HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(16) Endowments (continued)**

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

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
	<u>          </u>	<u>          </u>	<u>          </u>
Endowment net assets, beginning of year	\$ 1,296,336	4,783,247	6,079,583
Investment return:			
Investment income	78,669	–	78,669
Contributions	39,455	109,371	148,826
Appropriation of endowment assets for expenditures	<u>(1,108,693)</u>	<u>–</u>	<u>(1,108,693)</u>
Endowment net assets, end of year	\$ <u>305,767</u>	<u>4,892,618</u>	<u>5,198,385</u>

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

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
	<u>          </u>	<u>          </u>	<u>          </u>
Endowment net assets, beginning of year	\$ 87,260	4,634,397	4,721,657
Investment return:			
Investment income	75,125	–	75,125
Contributions	593,727	148,850	742,577
Appropriation of endowment assets for expenditures	(96,914)	–	(96,914)
Other changes			
Adjustments for affiliation	<u>637,138</u>	<u>–</u>	<u>637,138</u>
Endowment net assets, end of year	\$ <u>1,296,336</u>	<u>4,783,247</u>	<u>6,079,583</u>

## PRESBYTERIAN HOMES OBLIGATED GROUP

Notes to Combined Financial Statements

December 31, 2016 and 2015

### (16) Endowments (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 Obligated Group 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 Obligated Group 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 Obligated Group must hold in perpetuity for donor-specified purposes. 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 Obligated Group 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 Obligated Group 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 Obligated Group 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 HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### **(16) Endowments (continued)**

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

The Obligated Group has a total return policy for calculating the amounts available for distribution each year. It is a percent of its endowment funds' average fair value over the prior three calendar year ends. This percentage was 3.0% for both 2016 and 2015. Actual distributions are to satisfy donor restrictions. 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 Obligated Group considered the long-term expected return on its endowments. Accordingly, over the long term, the Obligated Group expects the current spending policy to allow its endowments to grow at an average of inflation plus one percent annually. For 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 Obligated Group'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) Retirement Plan**

Prior to affiliation, Cathedral Village had a 401(k) plan with employee-directed investment options and loan features. Employees who completed three months of service and had reached the age of 21 were eligible to make voluntary contributions to the plan. Cathedral Village matched contributions for employees who had met the eligibility requirements. Non-elective employer contributions covered employees who were eligible based on the age requirement or after completing 1,000 hours of service, whichever came later. On June 5, 2015, the Board of Directors of Cathedral Village approved merging this plan into the Obligated Group plan effective December 31, 2015.

The Obligated Group has a defined-contribution retirement plan covering all employees that 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 PHI 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 \$1,459,993 and \$1,415,067, respectively.

#### **(18) Commitments and Contingencies**

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

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### (19) 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, certificates of deposit and equity and fixed income securities is based on quoted market prices for the identical security.

Alternative investments: Alternative investments are held in private investment partnerships, which include publically traded securities, real estate and natural resources. Partnership agreements specify the type of investments held, liquidity, manager compensation, and other funding requirements. Management reviews, evaluates and monitors the values provided and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Annual independent audits of each private investment partnership are provided and included in management's review.

Beneficial interest in perpetual trusts: Fair value of the beneficial interest in perpetual trusts is based on the Obligated Group's percent ownership of the underlying trust assets, which approximate the value of estimated future cash flows to be received from the trust.

Contributions receivable from remainder trusts: Fair value of the contributions receivable from remainder trusts was based on the present value of future cash inflows.

Interest rate swap: Fair value of the interest rate swap is based on the net present value of expected future cash flows of the difference between the fixed interest rate of the interest rate swap and the counterparty's forward yield curve. The forward yield curve is readily available in public markets or can be derived from information available in publicly quoted markets.

Long-term debt and lines of credit: Long-term debt and lines of credit are carried at cost on the combined statements of financial position for lines of credit, bonds payable and mortgages payable as of December 31, 2016 and 2015. Fair value is based on quoted market prices for the same or similar issues. The totals outstanding were \$253,956,874 and \$245,985,638 as of December 31, 2016 and 2015, respectively. The carrying value of the long-term debt and lines of credit on the combined statements of financial position approximate the fair value.

## PRESBYTERIAN HOMES OBLIGATED GROUP

### Notes to Combined Financial Statements

December 31, 2016 and 2015

#### **(19) Financial Instruments (continued)**

The Obligated Group has a number of other financial instruments, none of which are held for investment purposes. The Obligated Group 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 combined 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 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 to the fair value methodologies used to measure fair value as of December 31, 2016 or 2015.

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined Financial Statements

December 31, 2016 and 2015

**(19) Financial Instruments (continued)**

For assets and liabilities 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>	<u>Level 2</u>	<u>Level 3</u>
Money market funds	\$ 25,400,722	25,400,722	–	–
Marketable equity securities	2,165,520	2,165,520	–	–
Equity securities	28,133,540	28,133,540	–	–
Fixed income securities	18,404,310	18,404,310	–	–
Alternative investments	28,245,265	–	–	28,245,265
Total investments	102,349,357	74,104,092	–	28,245,265
Beneficial interest in perpetual trusts	16,506,469	–	–	16,506,469
Contributions receivable from remainder trusts	718,301	–	–	718,301
Gift annuities	15,516	–	–	15,516
Total assets	\$ <u>119,589,643</u>	<u>74,104,092</u>	<u>–</u>	<u>45,485,551</u>
Interest rate swap	\$ <u>(33,034)</u>	<u>–</u>	<u>(33,034)</u>	<u>–</u>

For assets and liabilities 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>	<u>Level 2</u>	<u>Level 3</u>
Money market funds	\$ 33,622,259	33,622,259	–	–
Market equity securities	2,046,681	2,046,681	–	–
Equity securities	41,854,295	41,854,295	–	–
Fixed income securities	14,631,289	14,631,289	–	–
Alternative investments	24,553,972	–	–	24,553,972
Total investments	116,708,496	92,154,524	–	24,553,972
Beneficial interest in perpetual trusts	16,327,200	–	–	16,327,200
Contributions receivable from remainder trusts	652,092	–	–	652,092
Gift annuities	15,523	–	–	15,523
Total assets	\$ <u>133,703,311</u>	<u>92,154,524</u>	<u>–</u>	<u>41,548,787</u>
Interest rate swap	\$ <u>(80,945)</u>	<u>–</u>	<u>(80,945)</u>	<u>–</u>

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Notes to Combined financial statements

December 31, 2016 and 2015

**(19) Financial Instruments (continued)**

For investments falling within Level 3 in the fair value hierarchy, the activity recognized during the year ended December 31, 2016, is as follows:

<b>Description</b>	<b>Alternative Investments</b>	<b>Contributions Receivable from Remainder Trusts</b>	<b>Beneficial Interest in Perpetual Trusts</b>	<b>Gift Annuities</b>
Balance as of				
December 31, 2014	\$ 21,824,952	650,543	14,607,755	15,503
Unrealized gains (losses)	624,242	1,549	(915,337)	20
Adjustment for affiliation	-	-	2,424,292	-
Distributions	(2,045,234)	-	-	-
Contributions	3,866,140	-	210,490	-
Realized gains	283,872	-	-	-
Balance as of				
December 31, 2015	24,553,972	652,092	16,327,200	15,523
Unrealized gains (losses)	1,040,333	66,209	179,269	(7)
Distributions	(1,552,203)	-	-	-
Contributions	4,203,163	-	-	-
Balance as of				
December 31, 2016	\$ <u>28,245,265</u>	<u>718,301</u>	<u>16,506,469</u>	<u>15,516</u>

Unrealized and realized gains (losses) on alternative investments are reported as unrestricted and remainder trusts, gift annuities and beneficial interest in perpetual trusts are permanently restricted on the combined statements of operations and changes in net assets.

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

Financial instruments with off-balance-sheet risk to the Obligated Group consist of certain financial guarantees of its affiliates. The Obligated Group'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.

## **Independent Auditor's Report on Supplementary Information**

The Board of Trustees  
Presbyterian Homes Obligated Group

We have audited the combined financial statements of Presbyterian Homes Obligated Group (the Obligated Group), as of December 31, 2016 and 2015, and for the years then ended, and have issued our report thereon, which contains an unmodified opinion on those combined financial statements (see pages 2 and 3 of this document). Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole.

The combining supplementary information appearing on pages 47 through 49 is presented for purposes of additional analysis rather than to present the financial position and results of operations of the individual corporations and is not a required part of the combined financial statements. Additionally, the other supplementary information appearing on page 50 is presented for purposes of additional analysis and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining and other supplementary information has been subjected to the auditing procedures applied in the audits of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

*Arnett Carbis Toothman LLP*

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



**Presbyterian Homes Obligated Group**  
**Combining Schedule of Financial Position**  
**December 31, 2016**

See Independent Auditor's Report on Supplementary Information

Assets	Presbyterian Homes, Inc.	Presbyterian Homes in the Presbytery of Huntingdon	PHI Investment Management Services, Inc.	The Long Community, Inc.	Quincy Retirement Community	Cathedral Village	Obligated Group Subtotal	Eliminating Entries	Obligated Group Total
Cash and cash equivalents	\$ 1,026,476	56,382	-	262,152	42,094	501	1,387,605	-	1,387,605
Investments	855,423	9,067,170	34,886,424	8,845,919	4,342,238	10,172,427	68,169,601	-	68,169,601
Statutory liquid reserves	5,951,375	705,407	-	-	895,543	2,634,879	10,187,204	-	10,187,204
Accounts receivable, net	14,433,476	4,423,170	-	36,503	2,337,462	2,438,494	23,669,105	-	23,669,105
Prepaid expenses and other current assets	1,397,496	136,981	-	133,560	458,511	639,406	2,765,954	-	2,765,954
Assets whose use is limited	2,939,186	2,136,348	2,497,964	-	258,304	845,991	8,677,793	-	8,677,793
Assets whose use is limited, construction funds	6,996,122	5,392,853	-	-	2,925,784	-	15,314,759	-	15,314,759
Pledges receivable, net	425,627	200	-	-	18,000	3,120	446,947	-	446,947
Property and equipment, net	212,535,626	40,699,489	-	39,619,270	22,458,118	33,009,404	348,321,907	-	348,321,907
Assets under capital leases, net	155,930	118,485	-	12,829	38,635	30,959	356,838	-	356,838
Due from (to) affiliates	50,347,408	12,077,200	15,644,443	(13,433,590)	5,397,046	1,188,783	71,221,290	-	71,221,290
Funds held in trust by others	7,771,555	666,451	-	787,774	5,595,370	2,419,136	17,240,286	-	17,240,286
Beneficial interest in assets of affiliate	1,772,253	-	-	-	-	-	1,772,253	(1,772,253)	-
Goodwill	-	-	-	-	-	1,836,908	1,836,908	-	1,836,908
Other assets	23,752	-	-	-	-	-	23,752	-	23,752
<b>Total Assets</b>	<b>\$ 306,631,705</b>	<b>75,480,136</b>	<b>53,028,831</b>	<b>36,264,417</b>	<b>44,767,105</b>	<b>55,220,008</b>	<b>571,392,202</b>	<b>(1,772,253)</b>	<b>569,619,949</b>

**Prebyterian Homes Obligated Group**  
**Combining Schedule of Financial Position**  
**December 31, 2016**

See Independent Auditor's Report on Supplementary Information

Liabilities and Net Assets	Presbyterian Homes, Inc.	Presbyterian Homes in the Presbytery of Huntingdon	PHI Investment Management Services, Inc.	The Long Community, Inc.	Quincy Retirement Community	Cathedral Village	Obligated Group Subtotal	Eliminating Entries	Obligated Group Total
Accounts payable	\$ 7,325,051	3,390,326	–	112,282	2,500,020	1,266,081	14,593,760	–	14,593,760
Accrued expenses	7,549,205	3,669,192	63,250	423,913	1,437,579	1,246,716	14,389,855	–	14,389,855
Lines of credit	14,095,665	–	–	–	–	–	14,095,665	–	14,095,665
Accrued interest	715,877	10,728	–	–	–	110,673	837,278	–	837,278
Resident deposits	737,050	111,500	–	17,200	66,863	281,500	1,214,113	–	1,214,113
Entrance fee payable	13,940,958	990,341	–	–	971,360	240,000	16,142,659	–	16,142,659
Deferred revenue – entrance fees	57,564,855	7,039,800	–	–	10,012,155	21,072,383	95,689,193	–	95,689,193
Deferred energy costs	–	–	–	–	–	1,202,833	1,202,833	–	1,202,833
Fair value of interest rate swap	33,034	–	–	–	–	–	33,034	–	33,034
Annuities payable	738,519	16,450	–	73,147	33,363	–	861,479	–	861,479
Long-term debt									
Obligations on capital leases	162,953	121,871	–	13,194	39,945	42,018	379,981	–	379,981
Long-term debt	160,430,463	17,295,981	–	30,880,228	15,589,669	13,543,318	237,739,659	–	237,739,659
<b>Total liabilities</b>	<b>263,293,630</b>	<b>32,646,189</b>	<b>63,250</b>	<b>31,519,964</b>	<b>30,650,954</b>	<b>39,005,522</b>	<b>397,179,509</b>	<b>–</b>	<b>397,179,509</b>
Net assets:									
Unrestricted	31,254,249	39,935,304	51,193,328	3,949,456	8,117,876	13,601,367	148,051,580	–	148,051,580
Temporarily restricted	1,345,082	234,426	–	7,223	144,601	193,984	1,925,316	–	1,925,316
Permanently restricted	10,738,744	2,664,217	1,772,253	787,774	5,853,674	2,419,135	24,235,797	(1,772,253)	22,463,544
<b>Total net assets</b>	<b>43,338,075</b>	<b>42,833,947</b>	<b>52,965,581</b>	<b>4,744,453</b>	<b>14,116,151</b>	<b>16,214,486</b>	<b>174,212,693</b>	<b>(1,772,253)</b>	<b>172,440,440</b>
<b>Total liabilities and net assets</b>	<b>\$ 306,631,705</b>	<b>75,480,136</b>	<b>53,028,831</b>	<b>36,264,417</b>	<b>44,767,105</b>	<b>55,220,008</b>	<b>571,392,202</b>	<b>(1,772,253)</b>	<b>569,619,949</b>

**Presbyterian Homes Obligated Group**

**Combining Schedule of Operations and Changes in Net Assets**

**Year Ended December 31, 2016**

**See Independent Auditor's Report on Supplementary Information**

	Presbyterian Homes, Inc.	Presbyterian Homes in the Presbytery of Huntingdon	PHI Investment Management Services, Inc.	The Long Community, Inc.	Quincy Retirement Community	Cathedral Village	Obligated Group Subtotal	Eliminating Entries	Obligated Group Total
Operating revenues, gains, and other support:									
Resident services	\$ 117,573,055	32,674,032	–	4,936,761	19,420,004	27,454,901	202,058,753	–	202,058,753
Interest and dividend income	651,193	260,766	470,962	339,336	395,612	411,472	2,529,341	(373,775)	2,155,566
Realized (loss) gain on investments	3,277	93,809	(845,659)	136,011	38,034	73,583	(500,945)	(23,687)	(524,632)
Gain on sale of property and equipment	553,778	–	–	–	–	–	553,778	–	553,778
Contributions, gifts and bequests	86,050	47,260	–	82,608	115,337	877	332,132	–	332,132
Net assets released from restrictions	1,096,455	97,180	–	17,055	53,540	1,050,439	2,314,669	–	2,314,669
<b>Total operating revenues, gains, and other support</b>	<b>119,963,808</b>	<b>33,173,047</b>	<b>(374,697)</b>	<b>5,511,771</b>	<b>20,022,527</b>	<b>28,991,272</b>	<b>207,287,728</b>	<b>(397,462)</b>	<b>206,890,266</b>
Expenses:									
Nursing services	30,915,620	9,549,226	–	654,884	5,887,819	6,253,292	53,260,841	–	53,260,841
Rehabilitation	8,574,793	2,560,758	–	–	1,331,474	1,244,311	13,711,336	–	13,711,336
Recreation and special services	3,248,875	846,807	–	114,532	636,293	740,321	5,586,828	–	5,586,828
Pharmacy	2,013,882	727,708	–	11,190	513,907	543,781	3,810,468	–	3,810,468
Social services	514,936	157,339	–	29	74,940	148,599	895,843	–	895,843
Physician services	199,416	120,296	–	9,000	42,058	292,203	662,973	–	662,973
Food services	12,352,923	3,678,794	–	603,081	1,664,447	4,582,066	22,881,311	–	22,881,311
Building operations and maintenance	12,797,350	2,738,809	–	1,141,330	2,089,262	3,671,959	22,438,710	–	22,438,710
Housekeeping	2,635,827	662,691	–	63,455	319,912	754,731	4,436,616	–	4,436,616
Laundry and linen	651,740	307,790	–	412	185,413	85,235	1,230,590	–	1,230,590
General and administrative	18,621,771	5,341,286	5,432	874,250	3,056,299	2,851,202	30,750,240	–	30,750,240
Employee benefits	7,748,432	2,756,910	–	191,093	1,493,787	1,207,787	13,398,009	–	13,398,009
Interest	4,534,618	331,459	–	1,083,084	237,583	590,370	6,777,114	(318,584)	6,458,530
Depreciation	10,388,033	2,136,677	–	1,103,165	1,347,687	2,758,345	17,733,907	–	17,733,907
Amortization	147,860	2,610	–	20,545	2,505	4,454	177,974	–	177,974
Fundraising and investment fees	374,237	160,748	320,790	47,022	77,098	64,381	1,044,276	(7,914)	1,036,362
<b>Total expenses</b>	<b>115,720,313</b>	<b>32,079,908</b>	<b>326,222</b>	<b>5,917,072</b>	<b>18,960,484</b>	<b>25,793,037</b>	<b>198,797,036</b>	<b>(326,498)</b>	<b>198,470,538</b>
Operating income (loss)	4,243,495	1,093,139	(700,919)	(405,301)	1,062,043	3,198,235	8,490,692	(70,964)	8,419,728
Change in fair value of interest rate swap	47,911	–	–	–	–	–	47,911	–	47,911
Loss on early extinguishment of debt	(154)	–	–	–	–	(123,498)	(123,652)	–	(123,652)
Loss on abandoned project	(411,418)	–	–	–	–	–	(411,418)	–	(411,418)
<b>Excess (deficit) of operating revenues, gains and other support over expenses</b>	<b>3,879,834</b>	<b>1,093,139</b>	<b>(700,919)</b>	<b>(405,301)</b>	<b>1,062,043</b>	<b>3,074,737</b>	<b>8,003,533</b>	<b>(70,964)</b>	<b>7,932,569</b>
Other changes:									
Transfer to affiliated entity	9,848,935	–	(9,848,935)	–	–	–	–	–	–
Reserve for related party receivable	(3,000,000)	–	–	–	–	–	(3,000,000)	–	(3,000,000)
Unrealized gain (loss) on investments	(133,618)	200,043	1,489,220	85,073	103,580	524,715	2,269,013	70,964	2,339,977
<b>Total other changes</b>	<b>6,715,317</b>	<b>200,043</b>	<b>(8,359,715)</b>	<b>85,073</b>	<b>103,580</b>	<b>524,715</b>	<b>(730,987)</b>	<b>70,964</b>	<b>(660,023)</b>
<b>Change in unrestricted net assets</b>	<b>10,595,151</b>	<b>1,293,182</b>	<b>(9,060,634)</b>	<b>(320,228)</b>	<b>1,165,623</b>	<b>3,599,452</b>	<b>7,272,546</b>	<b>–</b>	<b>7,272,546</b>
Temporarily restricted net assets:									
Contributions, gifts and bequests	587,851	69,619	–	20,963	150,170	39,455	868,058	–	868,058
Interest and dividend income	77,289	340	–	–	1,040	–	78,669	–	78,669
Unrealized gain on investments	144,497	11,422	–	–	710	–	156,629	–	156,629
Net assets released from restrictions	(1,096,455)	(97,179)	–	(17,055)	(53,541)	(1,050,439)	(2,314,669)	–	(2,314,669)
<b>Change in temporarily restricted net assets</b>	<b>(286,818)</b>	<b>(15,798)</b>	<b>–</b>	<b>3,908</b>	<b>98,379</b>	<b>(1,010,984)</b>	<b>(1,211,313)</b>	<b>–</b>	<b>(1,211,313)</b>
Permanently restricted net assets:									
Contributions, gifts and bequests	55,744	44,995	–	–	8,632	–	109,371	–	109,371
Change in fair value of funds held in trust by others	164,421	1,046	91,031	(25,427)	43,563	(6,193)	268,441	(91,031)	177,410
<b>Change in permanently restricted net assets</b>	<b>220,165</b>	<b>46,041</b>	<b>91,031</b>	<b>(25,427)</b>	<b>52,195</b>	<b>(6,193)</b>	<b>377,812</b>	<b>(91,031)</b>	<b>286,781</b>
<b>Change in net assets</b>	<b>10,528,498</b>	<b>1,323,425</b>	<b>(8,969,603)</b>	<b>(341,747)</b>	<b>1,316,197</b>	<b>2,582,275</b>	<b>6,439,045</b>	<b>(91,031)</b>	<b>6,348,014</b>
Net assets, beginning of year	32,809,577	41,510,522	61,935,184	5,086,200	12,799,954	13,632,211	167,773,648	(1,681,222)	166,092,426
<b>Net assets, end of year</b>	<b>\$ 43,338,075</b>	<b>42,833,947</b>	<b>52,965,581</b>	<b>4,744,453</b>	<b>14,116,151</b>	<b>16,214,486</b>	<b>174,212,693</b>	<b>(1,772,253)</b>	<b>172,440,440</b>

**PRESBYTERIAN HOMES OBLIGATED GROUP**

Statutory Minimum Liquid Reserves  
(See Independent Auditor's Report on Supplementary Information)

As of December 31, 2016

	Presbyterian Homes, Inc.	Presbyterian Homes in the Presbytery of Huntingdon	PHI Investment Management Services, Inc.	The Long Community, Inc.	Quincy Retirement Community	Cathedral Village	Obligated Group
2017 Budgeted Operating Expenses	\$ 118,778,079	32,653,660	276,680	5,894,942	20,440,457	28,044,384	206,088,202
Less: depreciation expense	(11,227,809)	(2,126,773)	–	(1,102,152)	(1,460,136)	(2,769,617)	(18,686,487)
Expenses subject to minimum liquid assets requirement	107,550,270	30,526,887	276,680	4,792,790	18,980,321	25,274,767	187,401,715
Percentage of residents subject to residence and care arrangements as of December 31, 2016	41%	23%	0%	0%	48%	75%	
	44,095,611	7,021,184	–	–	9,110,554	18,956,075	79,183,424
Statutory requirement	10%	10%	10%	10%	10%	10%	10%
Statutory minimum liquid reserve requirement	\$ 4,409,561	702,118	0	0	911,055	1,895,608	7,918,342 (a)
Next 12 months debt service payments:							
Total debt service for next 12 months	\$ 14,289,042	1,168,681	–	2,481,212	875,542	469,073	19,283,550
Percentage of residents subject to residence and care arrangements as of December 31, 2016	41%	23%	0%	0%	48%	75%	
Statutory minimum liquid reserve requirement	\$ 5,858,507	268,797	–	–	420,260	351,805	6,899,369 (b)
Statutory minimum liquid reserve, greater of (a) or (b)	\$ 5,858,507	702,118	–	–	911,055	1,895,608	9,367,288
Total per Bank Statements as of December 31, 2016	\$ 5,951,375	705,407	–	–	895,543	2,634,879	10,187,204
<b>Assets in excess (deficit) of statutory minimum liquid reserve requirement</b>	\$ 92,868	3,289	–	–	(15,512)	739,271	819,916