PRESBYTERIAN HOMES, INC.

Consolidated Financial Statements
and Schedule

December 31, 2008 and 2007

(With Independent Auditor's Report Thereon)

PRESBYTERIAN HOMES, INC.

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PRESBYTERIAN
SENIOR LIVING

Certification of Chief Executive and Chief Financial Officers

We are responsible for the consolidated financial statements and supporting information of Presbyterian Homes, Inc., as of December 31, 2008 and 2007, 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 established as the standard for the entire organization. We believe that this commitment, our processes and internal controls produce financial information that can be trusted.

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

Financial statements alone can never reflect the breadth and depth of our stewardship of this ministry. They do not report on our most significant assets, our employees and volunteers. They also do not reflect our most important stewardship role; our commitment to provide Christian understanding and compassion to those seniors entrusted to our care. We believe that we continue to successfully fulfill the financial and non-financial aspects of our mission, extending a proud tradition of ministry that has served older persons in the name of Christ for the past 81 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

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Independent Auditor's Report

The Board of Directors
Presbyterian Homes, Inc.:

We have audited the accompanying consolidated statements of financial position of Presbyterian Homes, Inc. (an affiliate of PHI, doing business as Presbyterian Senior Living) as of December 31, 2008 and 2007, and the related consolidated statements of operations and changes in net assets (liabilities), and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Presbyterian Homes, Inc. as of December 31, 2008 and 2007, and the changes in its net assets (liabilities), and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, Pennsylvania
March 20, 2009

PRESBYTERIAN HOMES, INC.

Consolidated Statements of Financial Position

December 31, 2008 and 2007

Assets	**2008**	**2007**
Current assets:		
Cash and cash equivalents	$ 1,217,854	926,020
Investments	11,841,341	47,850,343
Accounts receivable, net	8,074,483	7,013,439
Assets whose use is limited – required for current liabilities	1,297,342	606,645
Pledges receivable, current portion	411,660	418,966
Interest receivable	209,900	208,813
Inventory	229,553	185,000
Prepaid expenses and other current assets	687,899	724,217
Total current assets	23,970,032	57,933,443
Assets whose use is limited, net of current portion	7,778,480	9,410,438
Assets whose use is limited, capital assets held by trustee	9,257,955	—
Pledges receivable, net of current portion	543,351	762,021
Property and equipment (net of accumulated depreciation of $102,749,893 and $94,368,804, respectively)	130,710,493	122,546,501
Assets under capital leases (net of accumulated depreciation of $143,517 and $137,382, respectively)	240,867	112,139
Due from affiliates	17,864,212	13,720,222
Funds held in trust by others	8,733,876	11,378,399
Fair value of interest rate swaps	—	34,281
Deferred marketing costs (net of accumulated amortization of $2,514,573 and $2,144,722, respectively)	—	27,791
Deferred financing costs (net of accumulated amortization of $578,507 and $811,298, respectively)	2,880,061	3,519,112
Other receivables	146,679	10,000
Total assets	$ 202,126,006	219,454,347

See accompanying notes to financial statements.

(Continued)

PRESBYTERIAN HOMES, INC.

Consolidated Statements of Financial Position

December 31, 2008 and 2007

Liabilities and Net Assets (Liabilities)	**2008**	**2007**
Current liabilities:		
Accounts payable	$ 6,683,487	4,518,142
Accrued expenses	8,892,846	7,468,692
Notes payable - line of credit	14,450,559	4,986,398
Accrued interest	734,530	399,900
Current portion:		
Annuities payable	152,033	156,596
Obligations under capital leases	91,055	79,046
Long-term debt	2,623,430	3,127,022
Total current liabilities	33,627,940	20,735,796
Resident deposits	1,727,171	1,757,654
Deferred revenue – entrance fees	46,392,687	45,575,550
Fair value of interest rate swaps	2,743,485	—
Annuities payable, net of current portion	728,476	774,494
Long-term debt, net of current portion:		
Obligations under capital leases	132,708	28,179
Long-term debt	123,651,741	105,045,517
Total liabilities	209,004,208	173,917,190
Net assets (liabilities):		
Unrestricted	(20,003,661)	30,445,021
Temporarily restricted	3,393,814	3,432,201
Permanently restricted	9,731,645	11,659,935
Total net assets (liabilities)	(6,878,202)	45,537,157
Total liabilities and net assets (liabilities)	$ 202,126,006	219,454,347

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

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

Years ended December 31, 2008 and 2007

	2008	2007
Operating revenues, gains, and other support:		
Resident services, including amortization of entrance fees of $5,967,989 and $6,387,227	$ 99,932,956	95,017,758
Interest and dividend income	1,974,071	2,476,936
Realized gains on investments	87,334	1,807,612
Gain on sale of property and equipment	638,861	1,230
Contributions, gifts and bequests	1,339,596	1,238,022
Net assets released from restrictions	430,548	692,842
Total operating revenues, gains, and other support	104,403,366	101,234,400
Expenses:		
Nursing services	30,637,367	28,248,401
Rehabilitation	3,855,706	3,873,386
Recreation and special services	3,446,178	3,118,476
Pharmacy	1,990,747	2,217,210
Social services	393,917	346,943
Physician services	237,337	246,830
Food services	10,730,463	10,173,978
Building operations and maintenance	10,265,680	10,073,385
Housekeeping	2,597,907	2,454,257
Laundry and linen	959,385	954,233
General and administrative	15,033,292	14,259,621
Employee benefits	8,224,735	7,951,480
Interest	4,983,270	5,188,032
Depreciation	7,615,147	7,427,852
Amortization	199,392	249,347
Total expenses	101,170,523	96,783,431
Income from continuing operations	3,232,843	4,450,969

See accompanying notes to consolidated financial statements.

(continued)

PRESBYTERIAN HOMES, INC.

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

Years ended December 31, 2008 and 2007

	2008	2007
Income from continuing operations	3,232,843	4,450,969
Discontinued operations:		
Discontinued operations, net of gain of $4,742,912 in 2007	–	4,833,334
Operating income	3,232,843	9,284,303
Decrease in fair value of interest rate swaps	(2,777,766)	(122,618)
Loss on early extinguishment of debt	(1,331,704)	–
Loss on abandoned project	–	(987,144)
(Deficit) excess of operating revenues, gains and other support over expenses	(876,627)	8,174,541
Other changes:		
Transfer of investments to PHI Investment Services Corporation	(31,992,466)	–
Unrealized (loss) gains on investments	(17,579,589)	54,440
Total other changes	(49,572,055)	54,440
(Decrease) increase in unrestricted net assets	(50,448,682)	8,228,981
Temporarily restricted net assets:		
Contributions, gifts and bequests	73,371	379,596
Interest and dividend income	114,760	8,169
Unrealized gain on investments	204,030	346,124
Net assets released from restrictions	(430,548)	(692,842)
Change in temporarily restricted net assets	(38,387)	41,047
Permanently restricted net assets:		
Contributions, gifts and bequests	26,591	60,913
Change in fair value of assets held in trust by others	(1,954,881)	131,727
Change in permanently restricted net assets	(1,928,290)	192,640
Change in net assets	(52,415,359)	8,462,668
Net assets, beginning of year	45,537,157	37,074,489
Net assets (liabilities), end of year	$ (6,878,202)	45,537,157

See accompanying notes to consolidated financial statements.

PRESBYTERIAN HOMES, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Change in net assets	$ (52,415,359)	8,462,668
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	7,615,147	7,460,546
Proceeds from entrance fees and deposits	8,007,439	8,654,112
Amortization of entrance fees	(5,967,989)	(6,387,227)
Loss on early extinguishment of debt	1,331,704	—
Unrealized loss on fair value of interest rate swaps	2,777,766	122,618
Unrealized losses (gains) on investments and assets held in trust by others	19,330,440	(532,291)
Realized gains on investments	(87,334)	(1,807,612)
Gain on sale of property, plant and equipment	(638,861)	(4,744,142)
Transfer of investments to PHI Investment Services Corporation	31,992,466	—
Contributions restricted for long-term purposes	(26,591)	(60,913)
Non-cash contribution from Grace Manor	(410,404)	—
Change in funds held in trust by others	—	26,917
Amortization	206,831	251,259
Amortization of bond discount	(7,439)	3,313
Loss on abandoned projects	—	987,144
Change in assets and liabilities:		
Accounts receivable	(1,061,044)	777,241
Pledges receivable	225,976	47,392
Other current assets	(9,322)	(224,163)
Other receivables	(136,679)	(3,558)
Accounts payable	2,165,345	(1,405,185)
Accrued expenses	1,758,784	253,707
Net cash provided by operating activities	14,650,876	11,881,826
Cash flows from investing activities:		
Acquisition of property and equipment	(15,412,546)	(8,956,165)
Net proceeds from the sale of property and equipment	1,120,708	6,598,230
Purchases of investments	(66,319,609)	(33,161,353)
Proceeds from sale of investments	45,420,868	35,268,027
Increase in due from affiliates	(4,143,990)	(9,544,315)
Net cash used in investing activities	(39,334,569)	(9,795,576)
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(1,252,796)	(2,046,870)
Principal payments on long-term debt	(59,843,204)	(2,989,162)
Proceeds on the issuance of bonds	77,379,072	—
Financing costs incurred	(864,254)	—
Borrowings on notes payable	9,464,161	2,542,579
Borrowings through capital leases	218,037	20,457
Repayments on capital lease obligations	(101,499)	(58,728)
Contributions restricted for long-term purposes	26,591	60,913
Change in annuities payable	(50,581)	40,326
Net cash provided by (used) in financing activities	24,975,527	(2,430,485)
Net increase (decrease) in cash and cash equivalents	291,834	(344,235)
Cash and cash equivalents, beginning of year	926,020	1,270,255
Cash and cash equivalents, end of year	$ 1,217,854	926,020

See accompanying notes to financial statements.

(1) General Information

Presbyterian Homes, Inc. (the Corporation) is a not-for-profit corporation, which provides services in the Presbyteries of Carlisle, Donegal, Kiskiminetas, Lackawanna, Lehigh, Northumberland, New Castle and Upper Ohio Valley in the states of Pennsylvania, Delaware, and Ohio. Presbyterian Homes, Inc. owns, operates and manages one stand alone skilled nursing facility, six continuing care retirement communities, two stand-alone independent living facilities and three stand alone assisted living homes. In total, the Corporation includes 635 independent living units, 359 assisted living units, and 711 nursing beds. The Corporation is governed by a Board of Directors, all of whom are elected by the Board of Trustees of PHI, doing business as Presbyterian Senior Living, the Corporation's parent organization.

On September 21, 2008, the Corporation acquired Kirkland Village through a merger. Kirkland Village was an affiliate of Presbyterian Senior Living. This merger has been accounted for as a pooling of interest, and as such, the Corporation's 2007 financial statements have been amended to include the results of Kirkland Village. The Corporation's consolidated financial statements for 2008 include the results of Kirkland Village as if it had been part of the Corporation for the full year starting on January 1, 2008. A summary of the changes to the 2007 statements is as follows:

		Original Audit 2007	KV Audited 2007	Amended 2007
Assets	$	165,798,236	53,656,111	219,454,347
Liabilities		118,320,565	55,596,625	173,917,190
Net assets (liabilities)		47,477,671	(1,940,514)	45,537,157
Results of operations:				
Unrestricted revenue	$	85,076,060	16,158,340	101,234,400
Unrestricted expenses		81,224,629	15,558,802	96,783,431
Change in unrestricted net assets		7,452,568	776,413	8,228,981
Change in temporarily restricted net assets		(9,459)	50,506	41,047
Change in permanently restricted net assets		182,096	10,544	192,640
Total change in net assets		7,625,205	837,463	8,462,668

On June 1, 2008, Grace Manor, an 18 unit independent living facility, affiliated with the Corporation and became a subsidiary of the Corporation. This affiliation was recorded as a contribution of $425,659. The consolidated financial statements of the Corporation include the financial position and operations of Grace Manor since June 1, 2008.

The Corporation has received a Certificate of Authority from the Pennsylvania Insurance Department as required by the Continuing Care Provider Registration and Disclosure Act of 1984, (the Act).

(continued)

(2) Summary of Significant Accounting Policies

(a) Basis of Consolidation

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

(b) Basis of Accounting

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

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

In December 2008, the Financial Accounting Standards Board issued FASB Staff Position (FSP) FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. The FSP defers the effective date of FASB Interpretation No 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, to be effective for fiscal years beginning after December 15, 2008 for certain nonpublic enterprises. The FSP requires a nonpublic enterprise that elects to defer the application of FIN 48 to explicitly disclose that fact and also requires the disclosure of the enterprise's accounting policy for evaluation uncertain tax positions for each set of financial statements where the deferral applies.

The Corporation has elected to defer the application of FIN 48. For the years ended December 31, 2008 and 2007, the Corporation has accounted for uncertain tax positions in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*.

(d) Use of Estimates

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

(continued)

(e) ***Cash and Cash Equivalents***

The Corporation considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents for the purposes of the statements of financial position and cash flows, except for those included in investments or assets whose use is limited. The Corporation's cash and cash equivalents are insured by the Federal Deposit Insurance Corporation up to $250,000 and $100,000 per bank as of December 31, 2008 and 2007, respectively. At December 31, 2008 the Corporation's cash balances did not exceed the FDIC coverage. At December 31, 2007, the Corporation's cash balances exceeded the FDIC coverage by $328,546.

(f) ***Investments***

Investments in marketable equity securities and mutual funds with readily determinable fair values and all investments in debt securities are measured at fair value, as determined by a national exchange in the statements of financial position. Alternative investments are not readily marketable and are presented at estimated fair value as determined by the investment managers. 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. 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, 2008 and 2007, no amounts were charged to realized loss as management believes the decline in value is temporary due to general economic conditions and not a permanent decline in value.

Investment income consisted of the following:

		2008	2007
Interest and dividends	$	2,088,831	2,485,105
Realized gains on investments		87,334	1,807,612
Unrealized (losses) gains on investments and assets held in trust by others		(19,330,440)	532,291
	$	(17,154,275)	4,825,008

Investment expenses of $158,067 and $219,629 as of December 31, 2008 and 2007, respectively have been included in general and administrative expenses.

(continued)

(g) ***Accounts Receivable***

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

		2008	2007
Total accounts receivable	$	9,727,323	8,527,198
Less: allowance for doubtful accounts		(1,652,840)	(1,513,759)
Net accounts receivable	$	8,074,483	7,013,439

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

(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. Amounts required to meet current obligations of the Corporation have been reclassified in the statement of financial position as current assets.

(i) ***Pledges Receivable***

The Corporation records pledges due in more than one year at the net present value less an allowance for uncollectibles.

		2008	2007
Pledges receivables	$	1,090,409	1,365,727
Less: unamortized discount		(55,398)	(85,953)
Subtotal		1,035,011	1,279,774
Less: allowance for uncollectibles		(80,000)	(98,787)
Net pledges receivables	$	955,011	1,180,987

Pledges receivable as of December 31, 2008 is as follows:

Amounts due in:		
Less than one year	$	478,395
One to five years		612,014
	$	1,090,409

(continued)

(j) ***Inventories***

Inventories consist of medical and dietary supplies. Inventory is valued at the lower of cost or market using the first-in, first-out method of inventory costing.

(k) ***Property and Equipment***

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

Depreciable lives are determined as follows:

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

(l) ***Costs of Borrowing***

Interest cost incurred on borrowed funds less interest income on these funds during the period of construction of capital assets is capitalized as a component of construction-in-progress. Interest of \$263,503 and \$0 was capitalized in 2008 and 2007, respectively.

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

The Corporation has 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 Corporation is notified of the trust's existence. The Corporation 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 at 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 contributions receivable from charitable remainder trusts that are held by independent trustees. Periodic payments are made to annuitants and the remaining corpus will revert to the Corporation upon 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.

(continued)

(m) Funds Held in Trust by Others (continued)

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

		2008	2007
Beneficial interest in perpetual trusts	$	5,478,687	7,257,861
Beneficial interest in assets of PHI Investment Services Corporation (2008) and Presbyterian Senior Living (2007)		1,508,610	2,127,650
Contributions receivable from remainder trusts		1,746,579	1,992,888
	$	8,733,876	11,378,399

(n) Derivatives and Hedging Activities

The Corporation utilizes interest rate swap agreements to hedge variable interest rates; which is accounted for using Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities.* For 2007, an adjustment to the asset was recorded causing a loss of $122,618. This adjustment represents the decrease in the fair value asset of the swap. For 2008, an adjustment to the asset was recorded causing a loss of $2,777,766. This adjustment represents the decrease in the fair value asset of the swap and created a (liability) of the swap.

The Corporation's interest rate swaps are carried at fair value asset (liability) as determined by a third party. Changes in fair value are reported in the statement of operations and changes in net assets as a component of the (deficit) excess of operating revenues, gains and other support over expenses.

(o) Deferred Costs

The Corporation 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. Amortization expense is expected to be approximately $182,591 for each of the next five years.

Deferred marketing costs had been amortized over the average life expectancy of initial residents. These costs are fully amortized as of December 31, 2008.

(p) 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.

(q) ***Estimated Obligation to Provide Future Services to Continuing Care Residents***

At certain continuing care retirement communities, the Corporation provides health care coverage for certain residents under the terms of a Residence and Care Agreement. The Corporation annually estimates the present value of the net cost of future services and the use of facilities to be provided to current residents covered by Residence and Care Agreements and compares that amount to the balance of deferred entrance fees. If the present value of the net cost of future services and the use of facilities exceeds the deferred entrance fees, a liability is recorded (estimated obligation to provide future services to continuing care residents, in excess of amounts received or to be received). Assumptions made in the calculation include a 4% inflation rate for nursing costs, a 4% inflation rate for other operating costs, and 6% discount rate based on the approximate cost of borrowing for the Corporation. Management's estimate resulted in no obligation in excess of recorded amounts to provide future services to continuing care residents.

(r) ***Resident Deposits***

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

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

Entrance fees collected from residents at move-in pursuant to a Residence and Care Agreement are initially recorded as deferred revenue. The non-refundable portion of the fees is amortized to income over the estimated remaining life expectancy of each resident. The portion of the guaranteed fee refundable upon reoccupancy is amortized on a straight-line basis over the remaining useful life of the applicable independent living unit. The agreements provide for potential death or termination refunds of the non-refundable portion if unit surrender occurs before the contractual amortization is completed in accordance with the terms of the agreements. The remaining amount of unamortized, nonrefundable entrance fees is recorded as revenue upon surrender of the independent living unit.

The amount of guaranteed refundable entrance fees due to residents at December 31, 2008 and 2007 under contractual refund provisions was approximately $19,764,000 and $18,843,000, respectively.

(t) ***Statutory Liquid Reserve***

The Continuing Care Provider Registration and Disclosure Act 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 Corporation 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. The reserve requirement is considered to be fulfilled by the Corporation's unrestricted cash and investments.

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

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

(v) ***Donor Restrictions***

The Corporation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose to which the donation is restricted is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement 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 financial statements.

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

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.

(continued)

(w) 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, Pennsylvania Medicaid and other third-party payors for services rendered. The Corporation derives a portion of its revenues from federal and state reimbursement programs with a significant majority of state reimbursement from Pennsylvania Medicaid. The Corporation is certified to receive benefits under Medicare and Medicaid.

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 Medicaid beneficiaries are paid at prospectively determined rates per day. These rates vary according to a resident classification system that is based on clinical diagnosis and other factors and the reimbursement methodology is subject to various limitations and adjustments. The Corporation's current concentration of skilled nursing facilities in Pennsylvania exposes it to the risk of changes in Medicaid reimbursement in this state.

Revenues from Medicare and Medicaid represent approximately 40% of revenues for 2008 and 2007. Medicare and Medicaid receivables represent approximately 58% and 61% of accounts receivable at December 31, 2008 and 2007, respectively.

The Corporation's nursing care facility primarily derives its revenue from private-pay, Medicare and Medicaid patients. Private-pay rates are established on the basis of the cost of delivering services and competitive considerations 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.

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 the Department of Public Welfare (DPW) based upon all non-Medicare days. The DPW 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 not yet been finalized for the period 7/1-12/31/08, however, estimates are included in revenue. For the years ended December 31, 2008 and 2007, the Corporation received or will receive approximately $874,441 and $895,858, respectively, in additional revenue for the net effect of this assessment and supplement.

(continued)

(x) ***Charity Care***

The Corporation provides care to residents who meet certain criteria under its charity care policy at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. In addition, the Corporation considers contractual allowances charity care. The total amount of charity care provided under these policies was approximately $8.1 million and $8.7 million for the years ended December 31, 2008 and 2007, respectively, of which the amount of charges foregone for services and supplies was approximately $1.6 million and $1.4 million, respectively.

(y) ***Donated Services***

Donated services are reflected in the financial statements at the fair value of the service donated. The Corporation pays for most services requiring specific expertise.

(z) ***Advertising***

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2008 and 2007, was $400,181 and $445,920, respectively.

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

		2008	2007
Program activities	$	86,137,231	81,823,506
General and administrative		14,701,441	14,608,349
Fundraising		331,851	351,576
	$	101,170,523	96,783,431

(ab) ***Fundraising Expense***

Fundraising expenses incurred by the Corporation are included in general and administrative on the consolidated statements of operations and changes in net assets (liabilities).

(ac) ***Operating Income***

The consolidated statements of operations and changes in net assets (liabilities) include an intermediate measure of operations labeled as "operating income." Changes in the performance indicator which are excluded from this measure include decrease in fair value of interest rate swaps,. loss on early extinguishment of debt and loss from abandoned project.

(continued)

(ad) *Performance Indicator*

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

(ae) *Consolidated Statement of Cash Flows*

Interest paid during the years ended December 31, 2008 and 2007 was $4,648,640 and $5,281,848, respectively. The Corporation recognized non-cash contributions of $410,404 from Grace Manor, which consisted of $977,168 of property and equipment, less a mortgage of $566,764.

(af) *Reclassifications*

Certain items in the 2007 financial statements have been reclassified to conform with the 2008 financial statement presentation. These reclassifications had no effect on the change in net assets.

(3) Investments

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

	2008		2007	
	Cost	Fair value	Cost	Fair value
Money market funds	$ 3,601,818	3,601,818	1,140,084	1,140,084
Certificates of deposit	20,789,366	20,789,366	–	–
Equity securities	–	–	28,193,583	30,899,134
Fixed income securities	4,095,390	4,095,390	20,973,977	21,293,971
Alternate investments	1,803,518	1,688,544	3,868,123	4,534,237
Totals	$ 30,290,092	30,175,118	54,175,767	57,867,426
Less assets whose use is limited (note 5)		(18,333,777)		(10,017,083)
Total investments		$ 11,841,341		$ 47,850,343

(3) Investments (continued)

In December 2008, the Corporation transferred $31,992,466 in investments to PHI Investment Management Services Corporation, as a part of the Presbyterian Senior Living's consolidation of investments and the management thereof. The Corporation has three certificates of deposit, three alternative investments and four fixed income investments as of December 31, 2008. The Corporation had eighteen mutual funds, three alternative investments, one equity investment and two fixed income investments as of December 31, 2007.

As of December 31, 2008, there was one alternate investment with a market value that had been below cost for less than a year, and in total the market value was than seven percent below cost. As of December 31, 2007, six mutual funds had a market value that had been below cost for less than a year, and in total, their market value was less than four percent below cost.

No individual holdings had a market value that had been below cost for more than a year as of December 31, 2007 and 2008.

A summary of investments with fair values below cost as of December 31, 2008 follows:

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Alternate investment	$ 387,474	(27,922)	—	—	387,474	(27,922)
Total temporarily impaired securities	$ 387,474	(27,922)	—	—	387,474	(27,922)

A summary of investments with fair values below cost as of December 31, 2007 follows:

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	$ 4,433,586	(172,050)	—	—	4,433,586	(172,050)
Total temporarily impaired securities	$ 4,433,586	(172,050)	—	—	4,433,586	(172,050)

(continued)

(4) Related Party Transactions

The Corporation incurs a management fee payable to its parent organization under a management agreement whereby Presbyterian Senior Living provides the Corporation with various management and administrative services to each of the Corporation's operating facilities. The Corporation also incurs certain operating expenses under the management agreement that are comprised primarily of the salaries and benefits of certain key management personnel provided to the Corporation by the parent organization. Under the terms of the management agreement, the Corporation shall reimburse Presbyterian Senior Living monthly in arrears by the fifteenth day of the following month in an amount equal to the cost of these management salaries and benefits plus other expenses as described in the agreement. During the years ended December 31, 2008 and 2007, the Corporation incurred management fees and other expenses under the management agreement totaling \$5,908,909 and \$5,737,644, respectively, which is classified as general and administrative expenses in the consolidated statement of operations and changes in net assets (liabilities).

In addition, the Corporation purchased medications from Continuing Care Rx, Inc. through July 2008. Presbyterian Senior Living is a minority shareholder in CCRx Holdings, Inc., the parent corporation of Continuing Care Rx, Inc. Total purchases from Continuing Care Rx, Inc. for 2008 and 2007 were approximately \$873,000 and \$2,183,000, respectively, of which \$0 and \$387,764 is included in accounts payable as of December 31, 2008 and 2007, respectively.

The Corporation is a guarantor of certain debts of Presbyterian Senior Living Services, Inc. (Glen Meadows), an affiliate organization. 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, Presbyterian Homes, Inc. has guaranteed payment up to \$6,000,000. The Corporation has also guaranteed a line of credit with a maximum available amount of \$1,250,000 for Presbyterian Senior Living Services, Inc., which is subject to renewal in May 2009.

Prelude Systems, Inc. (Prelude), is a joint venture between Presbyterian Senior Living and Diakon Lutheran Social Ministries. Prelude is a technical 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 healthcare and community service organizations. During 2008 and 2007, respectively, the Corporation paid Prelude approximately \$877,348 and \$774,099 for information services provided by Prelude, of which \$92,038 and \$139,905 is included in accounts payable as of December 31, 2008 and 2007, respectively.

Amounts due from affiliate entities, principally Presbyterian Senior Living and PHI Investment Management Services Corporation, as of December 31, 2008 and 2007 are \$17,864,212 and \$13,720,222, respectively.

The amounts receivable from the Corporation's affiliated organizations are unsecured, non-interest bearing and have no fixed repayment terms, except loans to Schartner House Associates.

(continued)

(4) Related Party Transactions (continued)

As discussed in Note 3, the Corporation transferred $31,992,466 in investments to PHI Investment Management Services Corporation, in December 2008. This transfer was completed as a part of the Presbyterian Senior Living's consolidation of investments and the management thereof. The Corporation has a beneficial interest in assets held in trust by PHI Investment Management Services Corporation of $1,508,610 at December 31, 2008. Prior to the consolidation of investments at PHI Investment Services Corporation, the Corporation's beneficial interest in assets held in trust was held by Presbyterian Senior Living. As of December 31, 2007 the balance of the beneficial interest in asset held in trust was $2,127,650.

As noted in Note 7, the Corporation became a part of the Presbyterian Homes Obligated Group (the Group) in 2008. Under this arrangement all of the members of the Group are jointly and severally liable for all the debt of each obligated group member.

(5) Assets Whose Use is Limited

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

	2008	2007
Permanently restricted investments	$ 2,046,642	2,020,051
Debt service reserve funds	5,731,838	7,390,387
Bond funds	1,297,342	606,645
Held by trustees - for future projects	9,257,955	-
	18,333,777	10,017,083
Less current portion	(1,297,342)	(606,645)
	$ 17,036,435	9,410,438

The Corporation's debt service reserve, bond and construction funds are required by certain covenants included in its bond indentures.

(6) Property and Equipment

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

	2008		2007	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Land	$ 11,937,065		10,259,097	
Land improvements	9,128,787	5,235,351	8,494,805	4,875,658
Buildings and improvements	180,305,537	80,658,452	171,904,034	73,455,594
Departmental equipment, furniture and fixtures	17,230,314	13,455,171	16,294,898	12,735,213
Furniture	2,286,481	2,147,526	2,283,268	2,098,096
Vehicles	1,457,090	1,253,393	1,484,543	1,204,243
Construction-in-progress	11,115,112		6,194,660	
	$ 233,460,386	102,749,893	216,915,305	94,368,804
Net book value		$ 130,710,493		$ 122,546,501

As the Corporation 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.

On October 1, 2008, the Corporation sold the administrative office and all the assets to Christ Community Church for approximately $1,069,000, and recognized a gain of $587,727. Additional gains on fixed assets totaled $51,134 and $1,230 during 2008 and 2007, respectively.

On October 9, 2008, the Corporation purchased the property adjacent to the Easton Home for approximately $195,000. The house on the property was demolished. Costs associated with the demolition were approximately $23,250.

On April 1, 2007, the Corporation sold Forest Park Health Center, a 114 bed nursing living facility for approximately $6,597,000, and recognized a gain of $4,742,912.

(continued)

(6) Property and Equipment (continued)

For the years ended December 31, 2007, Forest Park Health Center's gain consisted of:

		2007
Depreciation	$	(32,694)
Interest		(18,346)
Amortization		(569)
Other expenditures, net of gain of $4,742,912		4,884,943
Total gain on discontinued operations	$	4,833,334

During 2007, it was determined that a planned construction project at Saint Andrew's Village was not viable and $987,144 of assets was written off as costs associated with abandoned projects.

As of December 31, 2008, commitments for future construction totaled approximately $8,009,000.

(7) Long-term Debt

In 2008, the Corporation participated in the issuance of the Cumberland County Series 2008 A, B and C bonds, for which an obligated group (the Group) consisting of the Corporation, Quincy Retirement Community, Presbyterian Homes in the Presbytery of Huntingdon, Grace Senior Community Living Corporation, and PHI Investment Management Services are members. The financing obligates all members of the Group to be jointly and severally liable for the 2008 bonds, along with any prior indebtedness of each obligated group member. A portion of the funds were used to refund all of the Kirkland Village Northampton County Series 1998 and 2002 bonds and the Presbyterian Homes Cumberland County Series 2005B bonds. The Corporation realized a loss of $1,331,704 on early extinguishment of debt (net of $386,451 of gain). The remainder of the funds provided approximately $25 million for capital improvements and to pay for issuance costs. The $25 million is being held in a project fund at Bank of NY, the balance of which was $9,238,833 as of December 31, 2008.

(7) Long-term Debt (continued)

Long-term debt of the group and of the amounts payable by the Corporation as of December 31, 2008 consisted of the following:

	The Group	The Corporation
Cumberland County Municipal Authority Bonds Series 1993A, principal due in 2018, variable interest rate, 1.15% at December 31, 2008, collateralized by irrevocable letter of credit and by property and equipment and gross revenues of the Group.	6,000,000	6,000,000
Cumberland County Municipal Authority Revenue Bonds Series 2003A, tax exempt bonds, principal due in varying annual amounts from 2005 to 2026, interest rates ranging from 2.15% to 5%, insured by municipal bond insurance and collateralized by property and equipment and gross revenues of the Group	10,575,000	10,575,000
Cumberland County Municipal Authority Revenue Bonds Series 2003B, tax exempt variable rate bonds, principal maturities in varying amounts from 2004 to 2032, interest adjusted weekly, 1.33% at December 31, 2008, collateralized by letter of credit	8,405,000	8,405,000
Kent County Delaware Economic Development Revenue Bond Series 2003B, principal and interest payable monthly on a 15-year amortization period, final principal payment due October 31, 2018, variable interest of 1.80% at December 31, 2008, collateralized by property and equipment and gross revenues of the Group	7,170,358	7,170,358
Cumberland County Municipal Authority Revenue Bonds Series 2005A, tax exempt bonds, principal due in varying annual amounts from 2013 to 2020, interest rates ranging from 4% to 5%, insured by municipal bond insurance and collateralized by property and equipment and gross revenues of the Group	16,800,000	16,800,000
Cumberland County Municipal Authority Revenue Bonds Series 2008A, tax exempt bonds, principal due in varying annual amounts from 2009 to 2021, interest rates ranging from 4% to 5.45%, collateralized by property and equipment and gross revenues of the Group	17,415,000	16,582,650
Cumberland County Municipal Authority Revenue Bonds Series 2008B, tax exempt bonds, principal due in varying annual amounts from 2013 to 2038, interest adjusted weekly, 1.75% at December 31, 2008, collateralized by a letter of credit and by property and equipment and gross revenues of the Group	45,000,000	45,000,000

(continued)

(7) Long-term Debt (continued)

	The Group	The Corporation
Cumberland County Municipal Authority Revenue Bonds Series 2008C, taxable variable rate bonds, principal maturities in varying amounts from 2013 to 2026, interest adjusted weekly, 1.30% at December 31, 2008, collateralized by a letter of credit and by property and equipment and gross revenues of the Group	15,685,000	15,685,000
1995 Series A revenue note to Omega Financial, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to July 10, 2026. The note bears a floating rate which was 3.16% at December 31, 2008. The note is collateralized by a letter of credit and by property and equipment and gross revenues of the Group	2,847,828	—
1997 Series A Montgomery County Higher Education and Health Authority Demand Revenue Bonds, payable in monthly installments of principal and interest sufficient to amortize the principal balances to April 2017. The bonds bear a floating interest rate, which was 0.95% at December 31, 2008. The bonds are collateralized by a letter of credit and by property and equipment and gross revenues of the Group	6,855,000	—
Series 2002 Huntingdon County Industrial Development Authority, Mortgage Revenue Note, 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, which was 5.295% at December 31, 2008. The note is collateralized by a letter of credit and property and equipment and gross revenues of the Group	789,852	—
Series 2005 College Township Revenue Bonds, payable in equal installments of $25,248 per month to include principal and interest beginning October 2006 through September 2026. The bonds bear a floating rate of 5.01% as of December 31, 2008 The bonds are collateralized by property and equipment and gross revenues of the Group.	3,538,228	—
Mortgage note payable,Waynesboro Borough Authority, principal and interest payable monthly on a 20-year amortization period, due August 2027. The note bears an interest rate of 4.51% at December 31, 2008. The note is collateralized by property and equipment and gross revenues of the Group.	7,683,836	—

(continued)

(7) Long-term Debt (continued)

		The Group	The Corporation
Presbytery of Huntingdon revolving loan with no interest payable in annual installments of $5,000		10,000	—
		148,775,102	126,218,008
Less: Current portion		(3,838,138)	(2,623,430)
Unamortized discount		(309,729)	(311,852)
Plus: Unamortized premium		368,075	369,015
	$	144,995,310	123,651,741

Long-term debt as of December 31, 2007 consisted of the following:

		The Group	The Corporation
Cumberland County Municipal Authority Bonds Series 1993A, principal due in 2018, variable interest rate, 3.40% at December 31, 2007, secured by irrevocable letter of credit	$	—	6,000,000
Cumberland County Municipal Authority Revenue Bonds Series 2003A, tax exempt bonds, principal due in varying annual amounts from 2005 to 2026, interest rates ranging from 2.15% to 5%, insured by municipal bond insurance and property and equipment and gross revenues of Presbyterian Homes, Inc.		—	14,920,000
Cumberland County Municipal Authority Revenue Bonds Series 2003B, tax exempt variable rate bonds, principal maturities in varying amounts from 2004 to 2032, interest adjusted weekly, 3.39% at December 31, 2007, collateralized by letter of credit		—	8,540,000
Kent County Delaware Economic Development Revenue Bond Series 2003, principal and interest payable monthly on a 15-year amortization period, final principal payment due October 31, 2018, variable interest of 4.48% at December 31, 2007, collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.		—	7,765,747

(7) Long-term Debt (continued)

		The Group	The Corporation
Cumberland County Municipal Authority Revenue Bonds Series 2005A, tax exempt bonds, principal due in varying annual amounts from 2013 to 2020, interest rates ranging from 4% to 5%, insured by municipal bond insurance and collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.		—	16,800,000
Cumberland County Municipal Authority Revenue Bonds Series 2005B, taxable variable rate bonds, principal maturities in varying amounts from 2013 to 2026, interest adjusted weekly after first year, 4.25% December 31, 2007, insured by municipal bond insurance and collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.		—	16,800,000
Northampton County Industrial Development Authority Series 1998 First Mortgage Revenue Refunding Bonds, principal due in varying annual amounts through 2023, interest rate at 5.625%, collateralized by property and equipment and gross revenues of Presbyterian Housing and Services Corporation		—	14,045,000
Northampton County Industrial Development Authority Series 2002 First Mortgage Revenue Refunding Bonds, principal due in varying annual amounts through 2030, interest adjusted weekly, 3.39% at December 31, 2007, collateralized by a letter of credit		—	23,350,000
		—	108,220,747
Less: Current portion		—	(3,127,002)
Unamortized discount		—	(393,044)
Plus: Unamortized premium		—	344,816
	$	—	105,045,517

During November and December 2008, the Corporation repurchased $3,170,000 of the Cumberland County 2003A Series Bonds. These are being held with the option to remarket at a future date. A gain was recorded on the transactions of $386,451, which was netted against loss on early extinguishment of debt.

Under the terms of the Corporation's 2003 and 2005 Cumberland County Municipal Authority Revenue bond indenture, the Corporation is required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indentures also place limits on the incurrence of additional borrowings and requires the Corporation to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants have been met as of December 31, 2008 and 2007.

(7) Long-term Debt (continued)

Maturities for the five years subsequent to December 31, 2008 are as follows:

Years ended December 31,		The Group's Aggregate maturities	The Corporation's Aggregate maturities
2009	$	3,838,138	2,623,430
2010		4,373,371	3,083,356
2011		4,529,765	3,181,684
2012		4,731,482	3,319,294
2013		4,006,213	2,579,000
Thereafter		127,296,133	111,431,244
	$	148,775,102	126,218,008

(7) Long-term Debt (continued)

During 2008, the obligated group entered into six swap agreements with financial intermediaries, which fix the interest rates to be paid by the obligated group on the Cumberland County Series 1993 and 2008B bonds, a portion of the Cumberland County 2003B bonds, the Kent County 2003B bonds and the Montgomery County 1997 bonds as follows:

Notional Amount	Basis	Counterparty	Effective Date	Expiration Date	Interest Rate	Underlying Issue
$10,000,000	SIFMA MSI	M&T	06/05/08	06/01/11	2.81%	Cumberland County 2008 B
$10,000,000	SIFMA MSI	Wachovia	06/05/08	06/01/13	3.09%	Cumberland County 2008 B
$10,000,000	SIFMA MSI	Wachovia	06/05/08	06/01/15	3.28%	Cumberland County 2008 B
$29,540,000	SIFMA MSI	Morgan Stanley	10/09/08	10/01/10	2.552%	Cumberland County 2008 B, Cumberland County 1993 A, Cumberland County 2003 B
$6,855,000	SIFMA MSI	M&T	10/02/08	09/30/10	2.84%	Montgomery County 1997
$7,170,358	LIBOR	Bank of America	11/28/08	10/31/18	3.73%	Kent County 2003B

Pursuant to all these agreements the intermediary 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 Corporations. As discussed in Note 2, swap agreements are reported at fair value.

(8) Notes Payable

On February 15, 2008, the Corporation increased its line of credit with a financial institution, from allowing borrowings of up to $4,000,000 to $7,500,000 at a new interest rate based on the prime rate of the financial institution less one hundred and fifty basis points, which was 1.75% and 5.75% as of December 31, 2008 and 2007, respectively. The line of credit is collateralized by accounts receivable on a parity basis with the Corporation's bonded debt. The line was extended and expires on June 30, 2009. In 2008, the corporation entered into a second line of credit agreement with another financial institution. This agreement allows for borrowings up to $15,000,000 at a variable interest rate of 3.375%, as of December 31, 2008. The line of credit is collateralized by property, plant and equipment of the Group. As of December 31, 2008 and 2007, the Corporation had amounts totaling $14,450,559 and $4,986,398, respectively, outstanding under these agreements.

(9) Leases

The Corporation is obligated under various capital leases for equipment that expire at various dates during the next three years. At December 31, 2008 and 2007, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	2008	2007
Medical and office equipment	$ 384,384	249,561
Accumulated amortiztion	(143,517)	(137,422)
	$ 240,867	112,139

A schedule of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2008 follows:

2009	$ 98,044
2010	83,940
2011	53,167
	235,151
Amounts representing interest	(11,388)
	$ 223,763

(9) Leases (continued)

The Corporation leases certain equipment under operating leases, which expire at various dates through 2011. The future minimum lease payments under these operating leases are as follows:

2009	$ 115,221
2010	26,673
2011	3,745
	$ 145,639

Rental expense under operating leases was $179,221 and $190,444 for the years ended December 31, 2008 and 2007, respectively.

(10) Annuities

The Corporation has a gift annuity program. In return for their gifts, donors are paid a fixed annuity amount during the lifetime of the donor and/or the donor's beneficiary, which creates a liability of the Corporation. Total annuities payable were $880,509 and $931,090 at December 31, 2008 and 2007, respectively. The Corporation 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 Corporation has assets included in investments of $1,083,493 and $1,113,894 as of December 31, 2008 and 2007, respectively to satisfy annuities.

(11) Workers' Compensation Insurance

The Corporation has instituted a self-insured Workers' Compensation program as allowed by the Commonwealth of Pennsylvania and State of Delaware Bureaus of Workers' Compensation. This program provides for self payment of work related injuries and illnesses as opposed to utilizing an insurance carrier. The Corporation has contracted with major insurance carriers for excess insurance coverage, loss control services and administration. The Corporation maintains a letter of credit for $4,300,000 in connection with this self-insurance program. At December 31, 2008 and 2007, the Corporation has recorded an accrued expense of approximately $4.2 million and $3.9 million, respectively for workers' compensation claims which includes known case reserves and an estimate of the Corporation's liability for incurred but not reported claims.

(continued)

(12) Temporarily Restricted Net Assets

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

	2008	2007
Beneficial interest in assets of PHI Investment Management Services Corporation (2008) and Presbyterian Senior Living (2007)	$ 678,524	1,297,564
Charity care and/or equipment, including pledges receivable:		
Endowment	237,572	140,760
Other	2,107,368	1,552,925
Contributions receivable from remainder trusts	370,350	440,952
	$ 3,393,814	3,432,201

Net assets of $430,548 and $692,842 were released from restriction during 2008 and 2007 respectively in satisfaction of the above restrictions.

(13) Permanently Restricted Net Assets

Income from the following permanently restricted net assets as of December 31 is restricted for:

	2008	2007
Beneficial interest in assets of PHI Investment Management Services Corporation (2008) and Presbyterian Senior Living (2007)	$ 830,086	830,086
Contributions receivable from remainder trusts	1,376,230	1,551,937
Charity care and/or equipment	2,046,642	2,020,051
Beneficial interest in perpetual trusts	5,478,687	7,257,861
	$ 9,731,645	11,659,935

(14) Endowment

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

(14) Endowment (continued)

Interpretation of relevant law

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

The following schedule represents the changes in endowment net assets for the year ended December 31, 2008:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 140,760	2,020,051	2,160,811
Investment return:			
Investment income	114,760	–	114,760
Contributions	50,832	26,591	77,423
Appropriation of endowment assets for expenditures	(68,780)	–	(68,780)
Endowment net assets, end of year	$ 237,572	2,046,642	2,284,214

(14) Endowment (continued)

The following schedule represents the changes in endowment net assets for the year ended December 31, 2007:

		Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$	151,865	1,959,138	2,111,003
Investment return:				
Investment income		109,322	–	109,322
Contributions		–	60,913	60,913
Appropriation of endowment assets for expenditures		(120,427)	–	(120,427)
Endowment net assets, end of year	$	140,760	2,020,051	2,160,811

Funds with Deficiencies

The fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the relevant state law requires the Corporation to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, these deficiencies are reported as unrestricted net assets. There were no such deficiencies reported at December 31, 2008 or 2007.

Return Objectives and Risk Parameters

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

(continued)

(14) Endowment (continued)

Strategies Employed for Achieving Objectives

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

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

The Corporation has a total return policy for calculating the amounts available for distribution each year a percent of its endowment fund's average fair value over the prior three calendar year ends. This percentage was 4.0% for 2008 and 2007. Actual distributions are for specific projects approved by the Board of Directors. If the total return amount exceeds the actual earnings of the Endowment Funds in any one year, then the amount needed to fund such excess will first be taken from the accumulated excess earnings from prior years, then from the accumulated net capital gains of Endowment Funds and, conversely, any undistributed income after the allocation of the total return distribution is added back to the unrestricted or temporarily restricted fund balance. In establishing this policy, the Corporation considered the long-term expected return on its endowment. Accordingly, over the long term, the Corporation expects the current spending policy to allow its endowment to grow at an average of inflation plus one percent annually. For 2008 and 2007 an allocation of four percent of the prior year's balance was used to calculate restricted funds available balance. This is consistent with the Corporation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

(15) Retirement Plan

The Corporation participates in a defined-contribution retirement plan through Presbyterian Senior Living. The plan covers 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 Presbyterian Senior Living, and employees have the ability to direct how their contributions are invested. For the year ended December 31, 2008 and 2007, retirement plan expense totaled approximately $691,000 and $916,000, respectively.

(16) Commitments and Contingencies

The Corporation 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 Corporation's assets, liabilities, net assets, operations or cash flows.

(17) Financial Instruments

(a) Fair Values of Financial Instruments

The following valuation techniques were used to measure the fair value of assets and liabilities in the table on page 38 on a recurring basis as of December 31, 2008:

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

Alternative investments: Fair value of alternative investments was based on estimated fair values provided by investment managers. Management reviews and evaluates the values and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value of measurement.

Beneficial interest in perpetual trusts and assets of PHI Investment Management Services Corporation: Fair value of the beneficial interest in perpetual trusts and assets of PHI Investment Management Services Corporation was based on the Corporation's percent ownership of the trust assets. The trust assets were valued based on quoted market prices for identical securities.

Contributions receivable from remainder trusts: Fair value of the contributions receivable from remainder trusts was based on the present value of future cash inflows. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value of measurement.

Interest rate swaps: Fair value of the interest rate swaps are 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. Therefore, the Corporation has categorized the interest rate swap as Level 2.

Long-term debt: Long-term debt is carried at cost in the statements of financial position for bonds payable and mortgages payable at December 31, 2008 and 2007. Fair value is based on quoted market prices for the same or similar issues. The total outstanding was $126,275,171 and $108,172,539 at December 31, 2008 and 2007, respectively, and its fair values at December 31, 2008 and 2007 approximates $98,564,189 and $107,408,251, respectively.

The Corporation has a number of other financial instruments, none of which are held for investment purposes. The Corporation estimates that the fair value of all financial instruments at December 31, 2008 and 2007 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying consolidated statements of financial position.

(17) Financial Instruments (continued)

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007.

The primary effect of SFAS 157 on the Organization was to expand the required disclosures pertaining to the methods used to determine fair values.

SFAS 157 established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS 157 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 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.

(continued)

(17) Financial Instruments

For assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2008 are as follows:

Description	Total	Level 1	Level 2	Level 3
Money market funds and certificates of deposit	$ 24,391,184	24,391,184	–	–
Fixed income securities	4,095,390	4,095,390	–	–
Alternate investments	1,688,544	–	–	1,688,544
Total investments	30,175,118	28,486,574	–	1,688,544
Beneficial interest in perpetual trusts	5,478,687	5,478,687	–	–
Beneficial interest in assets of PHI Investment Management Services Corporation	1,508,610	1,508,610	–	–
Contributions receivable from remainder trusts	1,746,579	–	–	1,746,579
Interest rate swap	(2,743,485)	–	(2,743,485)	–

For assets falling within the Level 3 in the fair value hierarchy, the activity recognized during the year ended December 31, 2008 is as follows:

Description	Altermative Investments	Contributions Receivable from Remainder Trusts	Level 3 Total
Balance at December 31, 2007	$ 4,534,237	1,992,888	6,527,125
Unrealized losses	(1,062,193)	(246,309)	(1,308,502)
Proceeds received	1,562,375		1,562,375
Realized losses	(7,506)	–	(7,506)
Other changes - Transfers	(3,338,369)	–	(3,338,369)
Balance at December 31, 2008	$ 1,688,544	1,746,579	3,435,123

 (continued)

(17) Financial Instruments

Unrealized and realized losses on alternative investments are reported as unrestricted and remainder trusts are permanently restricted in the 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 Corporation consist of certain financial guarantees of its affiliates and letters of credit obtained from various financial institutions. The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual amount of those obligations.

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Independent Auditor's Report on Supplementary Information

To the Board of Directors
Presbyterian Homes, Inc.:

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The following supplementary information accompanying the consolidated financial statements is presented for purposes of additional analysis and is not required part of the basic consolidated financials statements. The supplementary information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and, accordingly, we express no opinion on such information.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, Pennsylvania
March 20, 2009

PRESBYTERIAN HOMES, INC.

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

As of December 31, 2008

2009 Budgeted Operating Expenses	$ 105,991,731	
Less: depreciation expense	(7,624,146)	
Expenses subject to minimum liquid assets requirement	98,367,585	
Percentage of residents subject to residence and care arrangements at December 31, 2008	46%	
	45,249,089	
Statutory requirement	10%	
Statutory minimum liquid reserve requirement	$ 4,524,909	(a)
Next 12 months debt service payments:		
Principal payments	$ 2,623,430	
Interest payments	4,794,188	
Total debt service for next 12 months	7,417,618	
Percentage of residents subject to residence and care arrangements at December 31, 2008	46%	
Statutory minimum liquid reserve requirement	$ 3,412,104	(b)
Assets satisfying statutory minimum liquid reserve requirement		
Unrestricted cash and investments	$ 11,975,702	
Greater of (a) or (b)	4,524,909	
Assets in excess of statutory minimum liquid reserve requirement	$ 7,450,793	