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PRESBYTERIAN HOMES OBLIGATED GROUP

Combined financial statements

December 31, 2008

(With Independent Auditor's Report Thereon)

PRESBYTERIAN HOMES OBLIGATED GROUP

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PRESBYTERIAN SENIOR LIVING

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, 2008, 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 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 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 102 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 Trustees
Presbyterian Homes Obligated Group

We have audited the accompanying combined statement of financial position of the Presbyterian Homes Obligated Group (the Obligated Group) as of December 31, 2008, and the related combined statement of operations and changes in net assets, and cash flow for the year then ended. These combined financial statements are the responsibility of the Obligated Group's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined 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 audit provides a reasonable basis for our opinion.

As described in Note 2(a), these special-purpose combined financial statements were prepared in accordance with the accounting requirements set forth in the Master Trust Indenture by and among the Obligated Group and the Bank of New York, dated May 1, 2008, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such requirements preclude the consolidation of certain affiliates which are not members of the Obligated Group.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Obligated Group as of December 31, 2008, and the change in its net assets, and its cash flow for the year then ended in accordance with the accounting requirements described in Note 2(a).

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, Pennsylvania
March 20, 2009

PRESBYTERIAN HOMES OBLIGATED GROUP

Combined Statement of Financial Position

December 31, 2008

Assets		**2008**
Current assets:		
Cash and cash equivalents	$	2,438,522
Investments		51,508,688
Accounts receivable, net		13,418,672
Assets whose use is limited - current portion		1,297,342
Pledges receivable, current portion		421,986
Interest receivable		209,900
Inventory		324,887
Prepaid expenses and other current assets		1,003,031
Total current assets		70,623,028
Assets whose use is limited, net of current portion		11,103,378
Assets whose use is limited, construction funds held by trustee		12,214,554
Pledges receivable, net of current portion		557,178
Property and equipment (net of accumulated depreciation of $152,592,858)		176,769,069
Assets under capital leases (net of accumulated depreciation of $252,196)		361,340
Due from affiliates		17,556,223
Funds held in trust by others		11,705,219
Unamortized deferred costs:		
Deferred financing costs, net of accumulated amortization of $876,255		3,179,069
Other assets		147,834
Total assets	$	304,216,892

See accompanying notes to combined financial statements.

(Continued)

PRESBYTERIAN HOMES OBLIGATED GROUP

Combined Statement of Financial Position

December 31, 2008

Liabilities and Net Assets		**2008**
Current liabilities:		
Accounts payable	$	9,176,026
Accrued expenses		13,361,544
Notes payable		14,471,788
Accrued interest		734,530
Current portion:		
Annuities payable		152,883
Obligations under capital leases		153,024
Long-term debt		3,838,138
Total current liabilities		41,887,933
Resident deposits		1,914,396
Deferred revenue - entrance fees		61,378,738
Fair value of interest rate swaps		2,883,121
Annuities payable, net of current portion		732,452
Accrued pension		651,586
Long-term debt, less current maturities:		
Obligations under capital leases		189,128
Long-term debt		144,995,310
Total liabilities		254,632,664
Net assets:		
Unrestricted		29,305,933
Temporarily restricted		3,639,242
Permanently restricted		16,639,053
Total net assets		49,584,228
Total liabilities and net assets	$	304,216,892

See accompanying notes to combined financial statements.

PRESBYTERIAN HOMES OBLIGATED GROUP

Combined Statement of Operations and Changes in Net Assets

Year ended December 31, 2008

		2008
Operating revenues, gains, and other support:		
Resident services, including amortization of entrance fees of $7,932,078	$	150,214,112
Interest and dividend income		2,796,245
Realized gains on investments		18,657
Gain on sale of property and equipment		615,733
Contributions, gifts and bequests		1,548,711
Net assets released from restrictions		587,774
Total operating revenues, gains, and other support		155,781,232
Expenses:		
Nursing services		47,390,318
Rehabilitation		6,268,001
Recreation and special services		4,856,164
Pharmacy		3,295,406
Social services		700,484
Physician services		386,763
Food services		16,049,617
Building operations and maintenance		15,466,989
Housekeeping		3,893,176
Laundry and linen		1,684,394
General and administrative		21,478,573
Employee benefits		12,282,101
Interest		5,839,813
Depreciation		10,746,775
Amortization		223,676
Total expenses		150,562,250
Operating income		5,218,982

See accompanying notes to combined financial statements.

(Continued)

PRESBYTERIAN HOMES OBLIGATED GROUP

Combined Statement of Operations and Changes in Net Assets

Year ended December 31, 2008

	2008
Operating income	5,218,982
Decrease in fair value of interest rate swaps	(2,917,402)
Loss on early extinguishment of debt	(1,331,704)
Excess of operating revenues, gains and other support over expenses	969,876
Other changes:	
Transfer of investments to PHI Investment Services Corporation	475,056
Pension-related changes other than net periodic pension costs	(309,830)
Unrealized loss on investments	(20,391,682)
Total other changes	(20,226,456)
Decrease in unrestricted net assets	(19,256,580)
Temporarily restricted net assets:	
Contributions, gifts and bequests	124,957
Interest and dividend income	114,760
Unrealized gain on investments	241,643
Net assets released from restrictions	(587,774)
Change in temporarily restricted net assets	(106,414)
Permanently restricted net assets:	
Contributions, gifts and bequests	138,344
Change in fair value of funds held in trust by others	(3,840,937)
Change in permanently restricted net assets	(3,702,593)
Change in net assets	(23,065,587)
Net assets, beginning of year	72,649,815
Net assets, end of year	$ 49,584,228

See accompanying notes to combined financial statements.

PRESBYTERIAN HOMES OBLIGATED GROUP

Combined Statement of Cash Flows

Year ended December 31, 2008

		2008
Cash flows from operating activities:		
Change in net assets	$	(23,065,587)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation		10,746,775
Proceeds from entrance fees and deposits		9,829,887
Amortization of entrance fees		(7,932,078)
Loss on early extinguishment of debt		1,331,704
Change in assets held in trust by others		2,318,522
Change in fair value of interest rate swaps		2,917,402
Unrealized loss on investments and change in fair value of funds held in trust by others		23,990,976
Realized gains on investments		(18,657)
Realized gain on sale of property and equipment		(615,733)
Transfer of investments to PHI Investment Management Services Corporation		(475,056)
Contributions restricted for long-term purposes		(138,344)
Non-cash contribution from Grace Manor		(410,404)
Amortization of deferred costs		231,459
Amortization of bond premium		(7,783)
Changes in assets and liabilities:		
Increase in accounts receivable		(1,773,430)
Decrease in pledges receivable		366,764
Increase in other assets		(93,172)
Increase in accounts payable		2,675,573
Increase in accrued expenses		2,399,546
Net cash provided by operating activities		22,278,364
Cash flows from investing activities:		
Acquisition of property and equipment		(19,465,900)
Net proceeds from sale of property and equipment		1,123,281
Transfer of investments to PHI Investment Management Services Corporation		475,056
Purchases of investments		(110,434,104)
Proceeds from sale of investments		85,490,777
Due from affiliates		(4,638,952)
Net cash used in investing activities		(47,449,842)
Cash flows from financing activities:		
Refunds of entrance fees and deposits		(1,683,671)
Principal payments on and redemptions of long-term debt		(60,995,148)
Proceeds from issuance of long-term debt		78,212,950
Financing costs incurred		(875,596)
Net borrowings of notes payable		9,485,390
Borrowings through capital leases		320,387
Repayments on capital leases		(157,728)
Contributions restricted for long-term purposes		138,344
Decrease in annuities payable		(45,755)
Net cash provided by financing activities		24,399,173
Net decrease in cash and cash equivalents		(772,305)
Cash and cash equivalents, beginning of year		3,210,827
Cash and cash equivalents, end of year	$	2,438,522

See accompanying notes to combined financial statements.

(1) General Information

The Presbyterian Homes Obligated Group(the Obligated Group) consists of the following not-for-profit corporations: Presbyterian Homes, Inc., Presbyterian Homes in the Presbytery of Huntingdon (PHPH), Quincy Retirement Community(QRC), Grace Senior Community Living Corporation(GSCLC) and PHI Investment Management Services, Inc. Between all the members of The Obligated Group, they own, operate and manage one stand alone skilled nursing facility, eleven continuing care retirement communities, two stand-alone independent living facility and three stand alone assisted living homes. In total, the Obligated Group includes 917 independent living units, 486 assisted living units, and 1220 nursing beds.

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

	Total	Pres Homes	PHPH	QRC	GSCLC
Nursing beds	1,220	711	376	133	—
Assisted living units	486	359	96	31	—
Independent living units	917	618	98	184	17
Total	2,623	1,688	570	348	17

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.

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

(2) Summary of Significant Accounting Policies

(a) Basis of Combination

These combined financial statements were prepared in accordance with the accounting requirements set forth in the master trust indenture by and among the Bank of New York, dated May 1, 2008, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such requirements preclude the consolidation of certain affiliates that are not members of the Obligated Group. All material intercompany transactions have been eliminated.

(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 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 Corporations have 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.*

(continued)

(d) *Use of Estimates*

The preparation of combined financial statements in accordance with the comprehensive basis of accounting 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.

(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 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 for up to $250,000 as of December 31, 2008. At December 31, 2008, the Obligated Group's cash balances exceeded the FDIC coverage by $414,561.

(f) *Investments*

Investments in marketable equity securities and mutual funds with readily determinable fair values and all investments in fixed securities are measured at fair value, as determined by a national exchange in the statement 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 year ended December 31, 2008, no amounts were charged to realized loss as management believes the decline in value is temporary due to the general economic conditions and not a permanent decline in value.

Investment income consisted of the following:

		2008
Interest and dividends	$	2,911,005
Realized gains on investments		18,657
Unrealized losses on investments and funds held in trust by others		(23,990,976)
	$	(21,061,314)

Investment expenses of $204,670 as of December 31, 2008 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
Total accounts receivable	$	15,500,452
Less: allowance for doubtful accounts		(2,081,780)
Net accounts receivable	$	13,418,672

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 Obligated Group 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 a discounted uncollectible amount.

		2008
Pledges receivables	$	1,121,098
Less: unamortized discount		(55,834)
Subtotal		1,065,264
Less: allowance for uncollectibles		(86,100)
Net pledges receivables	$	979,164

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

Amounts due in:		
Less than one year	$	495,784
One to five years		625,314
	$	1,121,098

(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 Obligated Group'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	3-35 years
Buildings and improvements	5-75 years
Departmental equipment, furniture and fixtures	1-40 years
Furniture	5-25 years
Vehicles	4 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 was capitalized in 2008.

(m) ***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 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 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.

(continued)

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

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

		2008
Beneficial interest in assets of Foundation	$	121,241
Beneficial interest in perpetual trusts		9,725,227
Contributions receivable from remainder trusts		1,803,904
Gift annuities		54,847
	$	11,705,219

(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 2008, an adjustment was recorded causing a loss of $2,917,402. This adjustment represents the decrease in the fair value (liability) of the swaps.

The Corporation's interest rate swaps are carried at fair value (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 excess of operating revenues, gains and other support over expenses.

(o) 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. Amortization expense is expected to be approximately $207,457 for each of the next five years.

(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.

(continued)

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

At certain Continuing Care Retirement Communities, the members of the Obligated Group provide health care coverage for certain residents under the terms of a Residence and Care Agreement. The Obligated Group 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). Management's assumptions used in the estimate may vary by facility. Assumptions made in these estimates include a 4% inflation rate for nursing costs, a 4% inflation rate for other operating costs, and a 6% discount rate based on the approximate cost of borrowing for the Corporation. Management's estimation 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 reoccupancy occurs before the contractual amortization is completed in accordance with the terms of the agreements. The remaining amount of unamortized, nonrefundable entrance fees is recorded as revenue upon surrender of the independent living unit.

The amount of entrance fees refundable to residents at December 31, 2008 under contractual refund provisions was approximately $23,735,228.

(continued)

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

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 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. The reserve requirement is considered to be fulfilled by the Obligated Group's unrestricted cash and investments.

(u) ***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.

(v) ***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 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 combined financial statements.

The Obligated Group reports gifts of cash and other assets as restricted support if they are received 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.

(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 Obligated Group derives a portion of its revenues from federal and state reimbursement programs with a significant majority of state reimbursement from Pennsylvania Medicaid. The Obligated Group 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 Obligated Group'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 46% of revenues for 2008. Medicare and Medicaid receivables represent approximately 60% of accounts receivable at December 31, 2008.

The Obligated Group'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. 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. For the year ended December 31, 2008, the Obligated Group received or will receive approximately $2,002,592 in additional revenue for the net effect of this assessment and supplement.

(x) Charity Care

The Obligated Group provides care to residents who meet certain criteria under its charity care policy at amounts less than its established rates. Because the Obligated Group does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. In addition, the Obligated Group considers contractual allowances charity care. The total amount of charity care provided under these policies was approximately $12.4 million for the year ended December 31, 2008, of which the amount of charges foregone for services and supplies was approximately $2.4 million.

(y) Donated Services

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

(z) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the year ended December 31, 2008 was $594,815.

(aa) Classification of expenses

		2008
Program activities	$	128,946,123
General and administrative		20,987,054
Fundraising		491,519
	$	150,424,696

(ab) Fundraising Expense

Fundraising expenses incurred by the Obligated Group are included in general and administrative on the combined statement of operations and changes in net assets.

(ac) Operating Income

The combined statement of operations and change 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 loss on the early extinguishment of debt and decrease in fair value of interest rate swaps.

(ad) Performance Indicator

The Obligated Group measures the performance of its operations using the combined statement of operations and change 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: pension-related changes other than net periodic pension costs and unrealized losses on investments.

(ae) Statement of Cash Flows

Interest paid during the year ended December 31, 2008 was $5,471,199. 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.

(3) Investments

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

	2008	
	Cost	Fair value
Money market funds	$ 7,102,272	7,102,272
Certificates of deposit	20,789,366	20,789,366
Equity securities	44,874,033	29,945,116
Fixed income securities	13,544,804	12,301,996
Alternate investments	6,615,243	5,985,212
Totals	$ 92,925,718	76,123,962
Less assets whose use is limited (note 5)		(24,615,274)
Total investments		$ 51,508,688

The Obligated Group invests primarily in a diversified portfolio of mutual funds. The Obligated Group has sixteen mutual funds, three alternative investments and several certificates of deposits and other fixed income securities as of December 31, 2008.

As of December 31, 2008, twelve mutual funds and four alternate investments had a market value that had been below cost for less than a year. In total, their market value was twenty seven percent below cost.

Six mutual funds had a market value that had been below cost for more than a year as of December 31, 2008. In total, their market value was thirty-eight percent below cost.

(continued)

(3) Investments (continued)

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
Mutual funds	$	33,372,846	(13,203,551)	4,778,877	(2,970,747)	38,151,723	(16,174,298)
Alternative Investments		5,178,294	(636,949)	—	—	5,178,294	(636,949)
Total temporarily impaired securities	$	38,551,140	(13,840,500)	4,778,877	(2,970,747)	43,330,017	(16,811,247)

(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 Corporation 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, 2008 and 2007, the Obligated Group incurred management fees and other expenses under the management agreement totaling $8,295,737, which is classified as general and administrative expenses in the combined statement of operations and changes in net assets.

In addition, the Obligated Group purchased medications from Continuing Care Rx, Inc. The Obligated Group terminated its contract with Continuing Care Rx, Inc. during 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 were approximately $1,353,634, of which $617 is included in accounts payable as of December 31, 2008.

(4) Related Party Transactions (continued)

Presbyterian Homes 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, the Obligated Group paid Prelude approximately $1,433,869 for information services provided by Prelude, of which $150,420 is included in accounts payable as of December 31, 2008.

Amounts due from affiliate entities, principally Presbyterian Senior Living, as of December 31, 2008 are $17,556,223.

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.

(5) Assets Whose Use is Limited

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

	2008
Permanently restricted investments	$ 4,531,423
QRC - unrestricted benevolent care	840,118
Bond fund	1,297,343
Debt service reserve fund	5,731,836
Held by trustee - for future projects	12,214,554
	24,615,274
Less current portion	(1,297,342)
	$ 23,317,932

(6) Property and Equipment

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

	2008	
	Cost	Accumulated depreciation
Land	$ 15,939,253	–
Land improvements	18,370,097	12,027,784
Buildings and improvements	238,162,250	106,295,673
Departmental equipment, furniture and fixtures	37,292,732	29,125,204
Furniture	3,242,630	3,070,703
Vehicles	2,311,517	2,073,494
Construction-in-progress	14,043,448	–
	$ 329,361,927	152,592,858
Net book value		$ 176,769,069

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.

On October 1, 2008, Presbyterian Homes, Inc. 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 $28,006 during 2008.

On October 9, 2008, Presbyterian Homes, Inc. 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.

As of December 31, 2008 approximately $10,793,000 was committed for future renovations.

(7) Long-term Debt

In 2008, the Obligated Group participated in the issuance of the Cumberland County Series 2008 A, B and C bonds. The financing obligates all members of the Obligated 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 2005B Series bonds. Presbyterian Homes realized a loss of $1,331,704, net of $386,451 of gain, on early extinguishment of debt. 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 $9,257,955 as of December 31, 2008.

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

	2008
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
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
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
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
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
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

(continued)

(7) Long-term Debt (continued)

	2008
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
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
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 3.95% 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

(continued)

(7) Long-term Debt (continued)

	2008
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
Presbytery of Huntingdon revolving loan with no interest payable in annual installments of $5,000	10,000
	148,775,102
Less: Current portion	(3,838,138)
Unamortized discount	368,075
Plus: Unamortized premium	(309,729)
	$ 144,995,310

During November and December 2008, Presbyterian Homes, Inc. 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 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, 2008.

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

Years ended December 31,	Aggregate maturities
2009	$ 3,838,138
2010	4,373,371
2011	4,529,765
2012	4,731,482
2013	4,006,213
Thereafter	127,296,133
	$ 148,775,102

(7) Long-term Debt (continued)

During 2008, the obligated group entered into five 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 Obligated Groups. As discussed in Note 2, swap agreements are reported at fair value.

(8) Notes Payable

The Obligated group has lines of credit with Bank of America. Interest rates on these lines of credit are variable based on the prime rate of the financial institution less one hundred and fifty basis points. The lines of credit are collateralized by property, plant and equipment of the Group. As of December 31, 2008, under the line of credit agreements, the Obligated Group had available a maximum of $23,500,000 from the financial institution. As of December 31, 2008, the Obligated Group had $14,471,788 outstanding under these agreements at interest rates of 1.75% and 3.375%.

(9) Leases

The Obligated Group is obligated under capital leases for equipment that expire in 2011. At December 31, 2008, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	2008
Office equipment	$ 613,536
Accumulated amortization	(252,196)
	$ 361,340

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, 2008 follows:

2009	$ 164,079
2010	120,372
2011	75,228
	359,679
Amounts representing interest	(17,527)
	$ 342,152

The Obligated Group 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	$ 157,655
2010	45,628
2011	8,660
	$ 211,943

Rental expense under operating leases was $225,295 for the year ended December 31, 2008.

(10) 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 Corporation. Total annuities payable were $885,335 at December 31, 2008. 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 $1,188,493 as of December 31, 2008 to satisfy annuities.

(11) 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. In 2008, the Obligated Group maintained a letter of credit for $4,300,000, in connection with this self-insurance program. At December 31, 2008, the Obligated Group has recorded an accrued expense of approximately $5.5 million for workers' compensation claims which includes known case reserves and an estimate of the Corporation's liability for incurred but not reported claims.

(12) Temporarily Restricted Net Assets

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

	2008
Trust assets held for the benefit of The Easton Home	$ 678,524
Charity care and/or equipment, including pledges receivable	
Endowment	237,572
Other	2,295,471
Contributions receivable from remainder trusts	427,675
	$ 3,639,242

Net assets of $587,774 were released from restriction during 2008 in satisfaction of the above restrictions.

(continued)

(13) Permanently Restricted Net Assets

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

		2008
Trust assets held for the benefit of The Easton Home	$	830,086
Investments to be held in perpetuity, the income from which is expendable to support:		
Operations		1,884,624
Charity care and/or equipment		2,646,799
Contributions recievable from remainder trusts		1,376,229
Beneficial interest in assets of foundation		121,241
Gift annuities		54,847
Beneficial interest in perpetual trusts		9,725,227
	$	16,639,053

(14) Endowment

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

(14) Endowment (continued)

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

		Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$	140,760	4,393,079	4,533,839
Investment return:				
Investment income		137,548	–	137,548
Net depreciation (realized and unrealized)		–	–	–
Contributions		50,832	138,344	189,176
Appropriation of endowment assets for expenditures		(91,568)	–	(91,568)
Endowment net assets, end of year	$	237,572	4,531,423	4,768,995

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 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 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 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 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.

(14) Endowment (continued)

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.

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 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 Obligated Group considered the long-term expected return on its endowment. Accordingly, over the long term, the Obligated Group 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 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.

(15) Retirement Plan

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 year ended December 31, 2008, retirement plan expense totaled approximately $1,035,187.

QRC has a defined benefit pension plan covering substantially all employees. This plan was curtailed and the benefits were frozen effective December 31, 2004. The benefits are based on years of service and the employee's average compensation during the last 10 years of employment. The Obligated Group's funding policy is to contribute annually the minimum amount required under statutory funding limitations. Contributions are intended to provide for benefits attributed to service through December 31, 2004. In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). Effective for the fiscal year ended December 31, 2007, QRC adopted the provisions of this standard and recognized the funded status of the plan that it sponsors.

(15) Retirement Plan (continued)

The following table sets forth the plan's funded status and amounts recognized in the Obligated Group's combined financial statements as of and for the year ended December 31:

		2008
Projected benefit obligation for service rendered to date	$	(2,933,492)
Plan assets at fair value		2,281,906
Accrued pension liability, net	$	(651,586)
Change in Benefit Obligation:		
Project benefit obligation - beginning of year	$	(2,732,684)
Interest cost		(163,420)
Distributions		101,545
Change due to assumptions as of end of year		(127,193)
Experience loss as of beginning of year		(11,740)
Projected benefit obligation - end of year	$	(2,933,492)
Change in Plan Assets:		
Fair value of plan assets - beginning of year	$	2,371,926
Actual return on plan assets		(154,332)
Contributions		170,097
Benefits Paid		(105,785)
Fair value of plan assets - end of year	$	2,281,906

The accumulated benefit obligation amounted to $2,933,492 as of December 31, 2008.

Items not recognized as a component of net period pension cost amounted to $825,075 December 31, 2008.

(continued)

(15) Retirement Plan (continued)

Net periodic pension expense included in following components for the years ended December 31, 2008:

		2008
Service cost	$	4,240
Interest cost		163,420
Expected return on plan assets		(194,157)
Amortiztion of unrecognized net loss		7,495
Net Periodic Pension Expense	$	(19,002)

The plan's funded status as of any measurement date is based on prevailing market conditions as to discount rate and plan assets and, accordingly, is subject to volatility.

The following weighted average rates were used in determining the actuarial present value of the projected benefit obligations and the related net periodic pension cost as of December 31, 2008:

	2008
Discount rate	5.75%
Expected rate of return on plan asset	8.0%
Rate of compensation increase	3.0%

The expected long-term rate of return on plan assets reflects the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. The selected rate considers the historical and expected future investment trends of the present and expected assets in the plan.

The expected return on plan assets was determined based on capital market assumptions developed by the Home's independent investment advisors along with other factors such as asset allocation target, investment manager performance, and overall pension performance. The capital market assumptions were projected over a five, ten and 30-years time horizon. Specifically, investment returns for the pension fund were projected over a 10-years period using varying equity allocations.

(continued)

(15) Retirement Plan (continued)

The pension plan assets were invested and allocated in the following manner as of December 31, 2008:

	2008
Equity securities	16.2%
Debt securities	83.8%
Other	0.0%

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid during the years ending December 31:

2009	47,284
2010	57,503
2011	71,325
2012	79,052
2013	90,676
2014-2017	659,962

QRC is not required and therefore, does not expect to contribute to the pension plan during the year ending December 31, 2009.

(16) 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.

(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 37 on a recurring basis as of December 31, 2008:

Money market funds, certificates of deposit and equity and fixed income securities: Fair value of money market funds, certificates of deposit and equity 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, assets of PHI Investment Management Services Corporation and net assets of foundation: Fair value of the beneficial interest in perpetual trusts, assets of PHI Investment Management Services Corporation and net assets of foundation was based on the Obligated Group'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. Fair value is based on quoted market prices for the same or similar issues. The total outstanding was $148,833,448 at December 31, 2008, and its fair values at December 31, 2008 approximates $118,111,091.

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 at December 31, 2008 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying 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 combined 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.

(17) 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 at December 31, 2008 are as follows:

Description	Total	Level 1	Level 2	Level 3
Money market funds and certificates of deposit	$ 27,891,638	27,891,638	–	–
Equity securities	29,945,116	29,945,116	–	–
Fixed income securities	12,301,996	12,301,996	–	–
Alternate investments	5,985,212	–	–	5,985,212
Total investments	76,123,962	70,138,750	–	5,985,212
Beneficial interest in perpetual trusts	9,725,227	9,725,227	–	–
Contributions receivable from remainder trusts	1,803,904	–	–	1,803,904
Gift annuities	54,847	–	–	54,847
Beneficial interest in assets of foundation	121,241	121,241	–	–
Interest rate swap	(2,883,121)	–	(2,883,121)	–

(17) Financial Instruments (continued)

For assets and liabilities 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	Gift Annuities
Balance at December 31, 2007	$	5,208,263	2,076,872	139,044
Contributions		46,026	–	–
Unrealized losses		(1,234,890)	(272,968)	(84,197)
Proceeds received		1,973,319		
Realized losses		(7,506)	–	–
Balance at December 31, 2008	$	5,985,212	1,803,904	54,847

Unrealized and realized losses on alternative investments are reported as unrestricted and remainder trusts are permanently restricted in the statement 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 and letters of credit obtained from various financial institutions. 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.

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Independent Auditor's Report on Supplementary Information

To the Board of Trustees
Presbyterian Homes Obligated Group:

Our audit was made for the purpose of forming an opinion on the combined financial statements taken as a whole. The following supplementary information accompanying the combined financial statements is presented for purpose of additional analysis and is not required part of the basic combined financials statements. The supplementary information has not been subjected to the auditing procedures applied in the audit of the combined 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 Obligated Group

Schedule of Combined Statement of Financial Position

December 31, 2008

Assets		Presbyterian Homes, Inc.	Presbyterian Homes in the Presbytery of Huntingdon	PHI Management Services Corporation	Quincy United Methodist Home	Obligated Group Subtotal	Eliminating Entries	Obligated Group Total
Current assets:								
Cash and cash equivalents	$	1,217,854	712,897	–	507,771	2,438,522	–	2,438,522
Investments		11,841,341	1,348,940	38,318,407	–	51,508,688	–	51,508,688
Accounts receivable, net		8,074,483	3,631,700	–	1,712,489	13,418,672	–	13,418,672
Assets whose use is limited – current portion		1,297,342	–	–	–	1,297,342	–	1,297,342
Pledges receivable, current portion		411,660	10,326	–	–	421,986	–	421,986
Interest receivable		209,900	–	–	–	209,900	–	209,900
Inventory		229,553	55,471	–	39,863	324,887	–	324,887
Prepaid expenses and other current assets		687,899	149,878	–	165,254	1,003,031	–	1,003,031
Total current assets		23,970,032	5,909,212	38,318,407	2,425,377	70,623,028	–	70,623,028
Assets whose use is limited, net of current portion		7,778,480	1,884,624	–	1,440,274	11,103,378	–	11,103,378
Assets whose use is limited, capital assets held by trustee		9,257,955	–	–	2,956,599	12,214,554	–	12,214,554
Pledges receivable, net of current portion		543,351	13,827	–	–	557,178	–	557,178
Property and equipment, net		130,710,493	31,779,333	–	14,279,243	176,769,069	–	176,769,069
Assets under capital lease, net		240,867	79,342	–	41,131	361,340	–	361,340
Due from (to) affiliates		17,864,212	1,075,523	(480,626)	(902,886)	17,556,223	–	17,556,223
Funds held in trust by others		8,733,876	521,459	–	3,958,494	13,213,829	(1,508,610)	11,705,219
Beneficial interest in assets of affiliate		–	2,733,598	–	–	2,733,598	(2,733,598)	–
Deferred financing costs, net		2,880,061	205,656	–	93,352	3,179,069	–	3,179,069
Other assets		146,679	–	–	–	146,679	1,155	147,834
Total assets	$	202,126,006	44,202,574	37,837,781	24,291,584	308,457,945	(4,241,053)	304,216,892

Presbyterian Homes Obligated Group

Schedule of Combined Statement of Financial Position

December 31, 2008

Liabilities and Net Assets		**Presbyterian Homes, Inc.**	**Presbyterian Homes in the Presbytery of Huntingdon**	**PHI Management Services Corporation**	**Quincy United Methodist Home**	**Obligated Group Subtotal**	**Eliminating Entries**	**Obligated Group Total**
Current liabilities:								
Accounts payable	$	6,683,487	1,710,958	–	781,581	9,176,026	–	9,176,026
Accrued expenses		8,892,846	3,477,942	–	990,756	13,361,544	–	13,361,544
Notes payable		14,450,559	21,229	–	–	14,471,788	–	14,471,788
Accrued interest		734,530	–	–	–	734,530	–	734,530
Current portion:								
Annuities payable		152,033	–	–	850	152,883	–	152,883
Obligations on capital leases		91,055	42,694	–	19,275	153,024	–	153,024
Long-term debt		2,623,430	952,694	–	262,014	3,838,138	–	3,838,138
Total current liabilities		33,627,940	6,205,517	–	2,054,476	41,887,933	–	41,887,933
Resident deposits		1,727,171	114,500	–	72,725	1,914,396	–	1,914,396
Deferred revenue – entrance fees		46,392,687	8,039,059	–	6,946,992	61,378,738	–	61,378,738
Fair value of interest rate swaps		2,743,485	139,636	–	–	2,883,121	–	2,883,121
Annuities payable		728,476	–	–	3,976	732,452	–	732,452
Accrued pension		–	–	–	651,586	651,586	–	651,586
Long-term debt, less current maturities:								
Obligations on capital leases		132,708	35,475	–	20,945	189,128	–	189,128
Long-term debt		123,651,741	13,921,747	–	7,421,822	144,995,310	–	144,995,310
Total liabilities		209,004,208	28,455,934	–	17,172,522	254,632,664	–	254,632,664
Net assets:								
Unrestricted		(20,003,661)	13,212,508	33,638,045	2,500,358	29,347,250	(41,317)	29,305,933
Temporarily restricted		3,393,814	185,374	–	60,054	3,639,242	–	3,639,242
Permanently restricted		9,731,645	2,348,758	4,199,736	4,558,650	20,838,789	(4,199,736)	16,639,053
Total net assets		(6,878,202)	15,746,640	37,837,781	7,119,062	53,825,281	(4,241,053)	49,584,228
Total liabilities and net assets	$	202,126,006	44,202,574	37,837,781	24,291,584	308,457,945	(4,241,053)	304,216,892

Presbyterian Homes Obligated Group

Schedule of Combined Statement of Operations and Chnages in Net Assets

Periods ended December 31, 2008

	Presbyterian Homes, Inc.	Presbyterian Homes in the Presbytery of Huntingdon	PHI Management Services Corporation	Quincy United Methodist Home	Obligated Group Subtotal	Eliminating Entries	Obligated Group Total
Operating revenues, gains, and other support:							
Resident services	$ 99,932,956	35,208,734	-	15,072,422	150,214,112	-	150,214,112
Interest and dividend income	1,974,071	277,893	212,713	337,030	2,801,707	(5,462)	2,796,245
Realized gains on investments	87,334	(53,303)	-	(15,374)	18,657	-	18,657
Gain on sale of property and equipment	638,861	2,573	-	(25,701)	615,733	-	615,733
Contributions, gifts and bequests	1,339,596	200,298	-	8,817	1,548,711	-	1,548,711
Net assets released from restrictions	430,548	147,500	-	9,726	587,774	-	587,774
Total revenues, gains, and other support	104,403,366	35,783,695	212,713	15,386,920	155,786,694	(5,462)	155,781,232
Expenses:							
Nursing services	30,637,367	11,606,853	-	5,146,098	47,390,318	-	47,390,318
Rehabilitation	3,855,706	1,654,351	-	757,944	6,268,001	-	6,268,001
Recreation and special services	3,446,178	981,923	-	428,063	4,856,164	-	4,856,164
Pharmacy	1,990,747	852,246	-	452,413	3,295,406	-	3,295,406
Social services	393,917	232,256	-	74,311	700,484	-	700,484
Physician services	237,337	90,575	-	58,851	386,763	-	386,763
Food services	10,730,463	3,816,106	-	1,503,048	16,049,617	-	16,049,617
Building operations and maintenance	10,265,680	2,932,226	-	2,269,083	15,466,989	-	15,466,989
Housekeeping	2,597,907	962,071	-	333,198	3,893,176	-	3,893,176
Laundry and linen	959,385	538,680	-	186,329	1,684,394	-	1,684,394
General and administrative	15,033,292	4,322,716	-	2,122,565	21,478,573	-	21,478,573
Employee benefits	8,224,735	2,740,849	-	1,316,517	12,282,101	-	12,282,101
Interest	4,983,270	630,419	-	226,124	5,839,813	-	5,839,813
Depreciation	7,615,147	1,898,781	-	1,232,847	10,746,775	-	10,746,775
Amortization	199,392	19,261	-	5,023	223,676	-	223,676
Total expenses	101,170,523	33,279,313	-	16,112,414	150,562,250	-	150,562,250
Operating Income	3,232,843	2,504,382	212,713	(725,494)	5,224,444	(5,462)	5,218,982
Decrease in fair value of interest rate swaps	(2,777,766)	(139,636)	-	-	(2,917,402)	-	(2,917,402)
Loss on early extinguishment of debt	(1,331,704)	-	-	-	(1,331,704)	-	(1,331,704)
Excess of operating revenues, gains and other support over expenses	(876,627)	2,364,746	212,713	(725,494)	975,338	(5,462)	969,876
Other changes:							
Transfer of investments to PHI Investment Services Corporation	(31,992,466)	-	32,467,522	-	475,056	-	475,056
Pension-related changes other than net periodic pension costs	-	-	-	(309,830)	(309,830)	-	(309,830)
Unrealized gains (losses) on investments	(17,579,589)	(2,869,212)	957,810	(864,836)	(20,355,827)	(35,855)	(20,391,682)
Decrease in unrestricted net assets	(50,448,682)	(504,466)	33,638,045	(1,900,160)	(19,215,263)	(41,317)	(19,256,580)
Temporarily restricted net assets:							
Contributions, gifts and bequests	73,371	30,253	-	21,333	124,957	-	124,957
Interest and dividend income	114,760	-	-	-	114,760	-	114,760
Unrealized gain on investments	204,030	37,613	-	-	241,643	-	241,643
Net assets released from restrictions	(430,548)	(147,500)	-	(9,726)	(587,774)	-	(587,774)
Change in temporarily restricted net assets	(38,387)	(79,634)	-	11,607	(106,414)	-	(106,414)
Permanently restricted net assets:							
Contributions, gifts and bequests	26,591	23,038	-	88,715	138,344	-	138,344
Net assets restriction	-	-	4,199,736	-	4,199,736	(4,199,736)	-
Change in fair value of assets held in trust by others	(1,954,881)	(148,748)	-	(1,737,308)	(3,840,937)	-	(3,840,937)
Change in permanently restricted net assets	(1,928,290)	(125,710)	4,199,736	(1,648,593)	497,143	(4,199,736)	(3,702,593)
Change in net assets	(52,415,359)	(709,810)	37,837,781	(3,537,146)	(18,824,534)	(4,241,053)	(23,065,587)
Net assets, beginning of year	45,537,157	16,456,450	-	10,656,208	72,649,815	-	72,649,815
Net assets, end of year	$ (6,878,202)	15,746,640	37,837,781	7,119,062	53,825,281	(4,241,053)	49,584,228