PHI

Consolidated Financial Statements

December 31, 2006 and 2005

(With Independent Auditor's Report Thereon)

PHI

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RETIREMENT AND SENIOR
CARE SERVICES

1217 Slate Hill Road • Camp Hill, Pennsylvania 17011

Certification of Chief Executive and Chief Financial Officers

We are responsible for the financial statements and supporting information of PHI, as of December 31, 2006 and 2005, and attest that they are accurate, complete and fairly presented.

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

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

Financial statements alone can never reflect the breadth and depth of our stewardship of this ministry. They do not report on our most significant assets, our employees and volunteers. They also do not reflect our most important stewardship role; our commitment to provide Christian understanding and compassion to those seniors entrusted to our care. We believe that we continue to successfully fulfill the financial and non-financial aspects of our mission, extending a proud tradition of a combined ministry that has served older persons in the name of Christ for the more than 100 years.

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

Stephen Proctor
Chief Executive Officer
PHI

Jeffrey J. Davis
Chief Financial Officer
PHI

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

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Independent Auditor's Report

The Board of Trustees
PHI:

We have audited the accompanying consolidated statements of financial position of PHI and affiliates (collectively the Corporation), as of December 31, 2006 and 2005, and the related consolidated statement of activities and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Geneva House, Inc., and Presbyterian Apartments, Inc., affiliates of PHI, which statements reflect total assets constituting .59 and .66 percent and total revenues constituting .87 percent and .89 percent, of the related 2006 and 2005 consolidated totals, respectively. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for Geneva House, Inc., and Presbyterian Apartments, Inc. is based solely on the reports of the other auditors. We also did not audit the 2005 financial statements of Quincy United Methodist Home. Those financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion, insofar as it relates to the amounts included for the 2005 Quincy United Methodist Home is based solely on the report of the other auditors.

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

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PHI and affiliates as of December 31, 2006 and 2005 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, PA
March 9, 2007

PHI

Consolidated Statements of Financial Position

December 31, 2006 and 2005

Assets		**2006**	**2005**
Current assets:			
Cash and cash equivalents	$	4,445,308	5,330,639
Investments		67,045,665	66,522,925
Accounts receivable, net		13,213,622	9,421,650
Assets whose use is limited - current portion		1,649,771	2,039,862
Pledges receivable, current portion		328,296	483,353
Interest receivable		52,676	171,279
Inventory		267,712	460,795
Prepaid expenses and other current assets		1,446,478	1,447,473
Total current assets		88,449,528	85,877,976
Assets whose use is limited, net of current portion		13,697,879	12,928,751
Pledges receivable, net of current portion		893,725	849,975
Property and equipment (net of accumulated depreciation of $162,238,195 and $150,967,591, respectively)		209,233,303	197,751,498
Assets under capital leases (net of accumulated depreciation of $134,662 and $42,409, respectively)		376,376	156,534
Assets held in trust by others		14,788,692	12,791,148
Fair value of interest rate hedges		156,899	164,599
Unamortized deferred costs:			
Deferred marketing costs, net of accumulated amortization of $2,078,023 and $2,003,518		94,490	168,995
Deferred financing costs, net of accumulated amortization of $1,695,127 and $1,466,272		4,360,546	4,590,053
Other assets		32,819	6,442
Total assets	$	332,084,257	315,285,971

See accompanying notes to consolidated financial statements.

(Continued)

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Consolidated Statements of Financial Position

December 31, 2006 and 2005

Liabilities and Net Assets		**2006**	**2005**
Current liabilities:			
Accounts payable	$	11,229,008	9,196,419
Accrued expenses - other		12,888,426	12,440,580
Notes payable		7,303,290	3,309,437
Accrued interest		717,311	595,757
Current portion:			
Annuities payable		179,807	187,044
Obligations on capital leases		166,896	62,615
Long-term debt		6,616,667	6,072,612
Total current liabilities		39,101,405	31,864,464
Resident deposits		1,538,249	1,846,200
Deferred revenue - entrance fees		79,776,651	78,231,419
Annuities payable		990,703	1,014,175
Accrued pension		302,676	630,544
Long-term debt, less current maturities:			
Obligations on capital leases		212,258	73,534
Long-term debt		149,813,391	154,024,483
Total liabilities		271,735,333	267,684,819
Net assets:			
Unrestricted		37,516,310	27,712,471
Temporarily restricted		3,609,567	3,278,022
Permanently restricted		19,223,050	16,610,659
Total net assets		60,348,927	47,601,152
Total liabilities and net assets	$	332,084,260	315,285,971

See accompanying notes to consolidated financial statements.

PHI

Consolidated Statements of Activities and Changes in Net Assets

Years ended December 31, 2006 and 2005

		2006	2005
Revenues, gains, and other support:			
Resident services, including amortization of entrance fees of $9,106,172 and $9,386,915	$	150,810,800	143,956,245
Sales of other services and materials		120,118	60,194
Net rental income		1,342,756	1,287,828
Interest and dividend income		3,352,298	3,369,918
Realized gains on investments		3,599,241	696,396
Gain on sale of property and equipment		663,837	–
Change in value of annuities		53,296	–
Gifts and bequests		1,300,432	1,528,278
Net assets released from restrictions		951,429	1,102,629
Total revenues, gains, and other support		162,194,207	152,001,488
Expenses:			
Nursing services		47,570,672	44,542,970
Rehabilitation		5,552,298	5,665,362
Recreation and special services		4,607,493	4,196,839
Pharmacy		3,389,710	3,069,716
Social services		618,136	651,672
Physician services		363,641	380,862
Food services		16,883,854	16,389,380
Building operations and maintenance		17,798,360	16,713,762
Housekeeping		4,214,388	4,031,090
Laundry and linen		1,729,049	1,780,022
General and administrative		21,307,723	22,869,088
Employee benefits		10,890,508	10,215,656
Interest		8,015,395	7,326,002
Depreciation		12,524,776	11,761,845
Amortization		194,869	426,920
Change in fair value of interest rate hedges		7,700	(379,205)
Loss on early extinguishment of debt		–	1,816,514
Total expenses		155,668,572	151,458,495
Change in unrestricted net assets before unrealized gains on investments discontinued operations, loss on abandoned projects and equity received from tax credit limited partner		6,525,635	542,993

See accompanying notes to consolidated financial statements.

(Continued)

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Consolidated Statements of Activities and Changes in Net Assets

Years ended December 31, 2006 and 2005

	2006	2005
Unrealized gains on investments	594,436	172,748
Discontinued operations	(29,512)	63,309
Loss on abandoned projects	(924,050)	–
Equity received from tax credit limited partner	3,637,330	–
Change in unrestricted net assets	9,803,839	779,050
Temporarily restricted net assets:		
Contributions, grants and bequests	545,419	856,047
Interest and dividend income	732,453	92,521
Unrealized gain on investments	5,102	178,653
Net assets released from restrictions	(951,429)	(1,102,629)
Change in temporarily restricted net assets	331,545	24,592
Permanently restricted net assets:		
Contributions	1,787,947	308,386
Change in fair value of assets held in trust by others	824,444	(56,918)
Change in permanently restricted net assets	2,612,391	251,468
Change in net assets	12,747,775	1,055,110
Net assets, beginning of year	47,601,152	46,546,042
Net assets, end of year	$ 60,348,927	47,601,152

See accompanying notes to consolidated financial statements.

PHI

Consolidated Statements of Cash Flows

Years ended December 31, 2006 and 2005

		2006	2005
Cash flows from operating activities:			
Change in net assets	$	12,747,775	1,055,110
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation		12,524,776	11,761,845
Proceeds from entrance fees and deposits		18,257,110	18,457,362
Amortization of entrance fees		(9,106,172)	(9,386,915)
Loss on early extinguishment of debt		–	1,816,514
Change in assets held in trust by others		(1,555,867)	19,473
Change in fair value of interest rate hedges		7,700	(379,205)
Change in value of annuities		(53,296)	–
Unrealized gains on investments and change in fair value of assets held in trust by others		(1,423,982)	(294,483)
Realized gains on investments		(3,599,241)	(696,396)
Realized gain on sale of property and equipment		(663,837)	–
Equity received from tax credit limited partner		(3,637,330)	–
Contributions restricted for long-term purposes		(1,787,947)	(308,386)
Amortization of deferred costs		303,360	396,570
Amortization of bond (premium) discount		(108,491)	30,350
Loss on abandoned projects		924,050	–
Changes in assets and liabilities:			
(Increase) decrease in accounts receivable		(3,785,704)	105,109
Decrease (increase) in pledges receivable		111,307	(265,397)
Decrease in other assets		286,304	117,811
Increase in accounts payable		2,032,587	1,179,335
Increase in accrued expenses		241,533	445,348
Net cash provided by operating activities		21,714,635	24,054,045
Cash flows from investing activities:			
Acquisition of property and equipment, net of disposals		(25,398,331)	(16,495,460)
Net proceeds from sale of property and equipment		925,307	2,226
Purchases of investments		(137,397,843)	(68,062,139)
Proceeds from sale of investments		141,082,933	68,568,615
Net cash used in investing activities		(20,787,934)	(15,986,758)

See accompanying notes to consolidated financial statements.

(Continued)

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Consolidated Statements of Cash Flows

Years ended December 31, 2006 and 2005

		2006	2005
Cash flows from financing activities:			
Refunds of entrance fees and deposits		(7,913,658)	(6,999,513)
Principal payments on and redemptions of long-term debt		(5,349,418)	(36,645,622)
Proceeds from issuance of long-term debt		1,790,871	35,633,551
Financing costs disposed (incurred)		28,749	(1,526,116)
Net borrowings of notes payable		3,993,853	2,496,090
Borrowings through capital leases		388,452	119,037
Repayments on capital leases		(145,448)	(33,856)
Equity received from tax credit limited partner		3,637,330	–
Contributions restricted for long-term purposes		1,787,947	308,386
(Decrease) increase in annuities payable		(30,710)	138,820
Net cash used in financing activities		(1,812,032)	(6,509,223)
Net (decrease) increase increase in cash and cash equivalents		(885,331)	1,558,064
Cash and cash equivalents, beginning of year		5,330,639	3,772,575
Cash and cash equivalents, end of year	$	4,445,308	5,330,639

See accompanying notes to consolidated financial statements.

(1) General Information

PHI (Corporation), a not-for-profit corporation, is the parent corporation of Presbyterian Homes, Inc.(Pres Homes), Presbyterian Housing and Services Corporation (PHSC), Presbyterian Senior Living Services, Inc. (PSLSI), Presbyterian Apartments, Inc. (PAI), and Geneva House, Inc. (GHI), which are controlled affiliates of PHI. The Corporation also owns 46 percent of Prelude Systems, Inc., a technical services organization, 6 percent of CCRx Holdings, Inc., a pharmaceutical company. In 2005, the Corporation owned 10 percent of a limited liability corporation called Alliance Rehab HVA, LLC. In May 2006, the Corporation redeemed its membership interest in Alliance Rehab HVA, LLC.(Note 5).

In 2006, the Corporation formed a new corporation, Schartner House, a wholly owned taxable affiliate for the purpose of building and operating a fifty unit affordable senior apartment building. More information is included in Note 6.

As of April 1, 2005 the board of directors, of the Presbyterian Homes in the Presbytery of Huntingdon (PHPH) amended the bylaws of that corporation to become a controlled affiliated of PHI. PHI's financial statements for 2005 include the results of PHPH as if it had been part of PHI for the full year starting in January 1, 2005.

As of October 1, 2006 the board of directors, of the Quincy United Methodist Home, doing business as Quincy Retirement Community (QRC) amended the bylaws of that corporation to become a controlled affiliated of PHI. This affiliation has been accounted for as a pooling of interest, and as such, PHI's 2005 financial statements have been amended to include the results of QRC. PHI's financial statements for 2006 include the results of QRC as if it had been part of PHI for the full year starting in January 1, 2006. A summary of the changes to the 2005 statements is as follows:

		Original Audit 2005	QRC Audited 2005	Amended 2005
Assets	$	288,316,775	26,969,196	315,285,971
Liabilities		251,459,364	16,225,455	267,684,819
Net assets		36,857,411	10,743,741	47,601,152
Results of operations:				
Unrestricted revenue	$	139,465,900	12,535,588	152,001,488
Unrestricted expenses		139,098,177	12,360,318	151,458,495
Other unrestricted		252,183	(16,126)	236,057
Change in unrestricted net assets		619,906	159,144	779,050
Change in temporarily restricted net assets		24,131	461	24,592
Change in permanently restricted net assets		244,393	7,075	251,468
Total change in net assets		888,430	166,680	1,055,110

(Continued)

(1) General Information (continued)

The Corporation serves as a management company for the above affiliates and is governed by a Board of Trustees. Some of the members of the Board of Trustees are also members of the Board of Directors of certain affiliated corporations. The Corporation's affiliates do business primarily in Pennsylvania, but also in Maryland, Ohio and Delaware.

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

	Total	Pres Homes	PHSC	PSLSI	PHPH	QRC	PAI	GHI
Nursing beds	1,366	766	60	31	376	133	—	—
Assisted living units	472	277	33	34	97	31	—	—
Independent living units	1,108	453	164	210	97	184	—	—
HUD housing units	228	—	—	—	—	—	164	64
Total	3,174	1,496	257	275	570	348	164	64

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

These consolidated financial statements have been prepared to focus on the Corporation as a whole. All material intercompany transactions have been eliminated.

These 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.

(b) Tax Status

PHI is tax exempt under Section 501(c)(3) of the Internal Revenue Code.

(c) ***Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles 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.

(d) ***Reclassification***

Certain amounts in the 2005 financial statements have been reclassified to conform with the 2006 financial presentation. These reclassifications had no effect on the change in net assets.

(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 purposes of the statements of cash flows. At times during the years ended December 31, 2006 and 2005, cash balances may have exceeded the federally insured limit of $100,000.

(f) ***Investments***

Investments in 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 – limited partnerships 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 – limited partnerships. 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, 2006 and 2005, no amounts were charged to realized loss for this purpose as management believes the decline in value is temporary due to general economic conditions and not a permanent decline in value.

(Continued)

Investment income consisted of the following:

		2006	2005
Interest and dividends	$	4,084,751	3,462,439
Realized gains on investments		3,599,241	696,396
Unrealized gains on investments and change in fair value of assets held in trust by others		1,423,982	294,483
	$	9,107,974	4,453,318

Investment expenses of $280,382 and $246,671 as of December 31, 2006 and 2005, respectively have been included in general and administrative expenses.

(g) *Accounts Receivable*

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

		2006	2005
Total accounts receivable	$	14,713,626	10,879,815
Less: allowance for doubtful accounts		(1,500,004)	(1,458,165)
Net accounts receivable	$	13,213,622	9,421,650

The allowance for doubtful accounts is established based on management's assessment of the collectibility of specific resident's accounts and the aging of 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. Amounts required to meet current obligations of the Corporation have been reclassified in the statement of financial position as current assets.

(i) *Pledges Receivable*

During 2003, a pledge was made to Presbyterian Homes, Inc. for $1,500,000. Additional pledges for Presbyterian Homes, Inc. and Presbyterian Housing and Services Corporation were received during 2006 and 2005 for $623,979, and $536,157. As of December 31, 2006, the organizations have received $1,143,162 of the gifts and the remaining balance will be paid over the next eight years. The Corporation recorded this pledge at the net present value less a discounted uncollectible amount of 10%.

(i) ***Pledges Receivable (continued)***

	2006	2005
Pledges receivables	$ 1,516,302	1,567,988
Less: unamortized discount	(162,526)	(195,804)
Subtotal	1,353,776	1,372,184
Less: allowance for uncollectibles	(131,755)	(38,856)
Net pledges receivables	$ 1,222,021	1,333,328

Pledges receivable as of December 31, 2006 is as follows:

Amounts due in:	
Less than one year	$ 436,067
One to five years	982,235
More than five years	98,000
	$ 1,516,302

(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. The Corporation's policy is to capitalize items in excess of $2,000 or for a group of items totaling $2,000 or more. Depreciation is being provided on the straight-line method over the estimated useful lives of the assets.

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	4-5 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 $24,740 and $250,465 was capitalized in 2006 and 2005, respectively.

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(m) Assets 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.

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

		2006	2005
Assets held in trust by others	$	12,704,757	11,934,862
Contributions receivable from remainder trusts		2,083,935	856,286
	$	14,788,692	12,791,148

(n) Derivatives and Hedging Activities

In accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities,* the Corporation recorded an asset of $156,899 and $164,599, representing the fair value asset of the swaps as of December 31, 2006 and 2005, respectively For 2006, an adjustment was recorded causing a loss of $7,700. This adjustment represents the decrease in the fair value asset of the swaps. For 2005, an adjustment was recorded causing a gain of $379,205 and creating an asset for the swaps. This adjustment represents the increase in the fair value asset of the swaps.

All of the Corporations' interest rate swaps are carried at fair value asset (liability) as determined by a third party. Changes in fair value are reported in the consolidated statement of activities and changes in net assets as a component of the change in net assets.

The terms of the various interest rate swaps are described in note 7.

(Continued)

(o) Deferred Costs

The Corporation has deferred the marketing costs incurred in connection with acquiring initial continuing care contracts for its independent living facilities. When the independent living units are substantially occupied, these costs are amortized on a straight-line basis over a period approximating the average life expectancy of the initial residents occupying the units.

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 $292,004 in 2007, $253,096 in 2008 and $225,305 in 2009, 2010 and 2011.

(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). 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 6% discount rate based on the approximate cost of borrowing for the Corporation. At December 31, 2006 and 2005, 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 resident 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 fee refundable upon reoccupancy is amortized on a straight-line basis over the remaining useful life of the applicable facility. For PHPH only, the portion of the fee that is refundable is based upon reoccupancy or six months, whichever is sooner. 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 a resident's death or termination of the contract.

The amount of entrance fees refundable to residents at December 31, 2006 and 2005 under contractual refund provisions was approximately $71,400,000 and $65,300,000, respectively.

(t) Recently Issued Accounting Pronouncements

On September 29, 2006, the Financial Accounting Standards Board , "FASB" issued FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* ("SFAS 158"), which amends FASB Statement No. 87 and FASB Statement No. 106 to require recognition of the overfunded or underfunded status of pensions and other postretirement benefit plans on the employer's balance sheet. Under FASB Statement No. 158, gains and losses, prior service costs and credits, and any remaining transition amounts under FASB Statement No. 87 and FASB Statement No. 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date –the date at which the benefit obligation and plan assets are measured-is required to be the Corporation's fiscal year end. FASB Statement No. 158 is effective for employers without publicly traded equity securities for fiscal years ending after June 15, 2007, except for measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Corporation is currently analyzing the effects of FASB Statement No. 158 on its financial condition, results of operations and cash flows. The Corporation has not yet quantified the financial impact of implementing FASB Statement No. 158.

(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. Net assets released from restriction consist of expenses incurred satisfying those restricted purposes. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity, the interest and dividend income from which is used for the charitable purpose.

(Continued)

(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 activities 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 upon 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.

(w) ***Resident Services Revenue and Business Concentration***

Resident services revenue is reported at the estimated net realizable amount to be received from patients and others including Medicare, Delaware Medicaid, Maryland Medicaid and Pennsylvania Medicaid and other third party payors for services rendered. The Corporation derives a significant portion of its revenue from federal and state reimbursement programs with a significant majority of state reimbursement from Pennsylvania Medicaid. All of the skilled nursing facilities operated by the Corporation are certified to receive benefits under Medicare and Medicaid.

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

Nursing services provided to Pennsylvania Medicaid beneficiaries are paid at prospectively determined rates per day. These rates vary according to a resident classification system that is based on clinical diagnostic 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.

(w) Resident Services Revenue and Business Concentration (continued)

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

Revenues from Medicare and Pennsylvania, Maryland and Delaware Medicaid (Medicaid) represent approximately 46% and 45% of consolidated revenues for both December 31, 2006 and 2005. Medicare and Medicaid receivables represent approximately 63% and 52% of consolidated accounts receivable at both December 31, 2006 and 2005.

The Commonwealth of Pennsylvania (the State) received approval from the Federal Center for Medicare Services (CMS), to retroactively assess a nursing bed assessment as follows:

July 1, 2004 to June 30, 2005: $1.50 a day for continuing care retirement community non-Medicare occupied beds, and $15.91 a day for stand alone nursing facility non-Medicare occupied beds. As a part of this, nursing home providers received an additional supplement of $7.05 a day, based on a number of factors, including their Medicaid utilization.

July 1, 2005 to June 30, 2006 $1.54 a day for continuing care retirement community non-Medicare occupied beds, and $15.95 a day for stand alone nursing facility non-Medicare occupied beds. As a part of this, nursing home providers received an additional supplement of $5.17 a day, based on a number of factors, including their Medicaid utilization.

The supplemental and assessment amounts per day have not yet been finalized for the period 7/1-12/31/06. The State has published proposed amounts but no amount has been included on the Corporation's financial statements for this period.

For the years ended December 31, 2006 and 2005 the Corporation received approximately $347,182 and $2.0 million in additional revenue, respectively for the net effect of this assessment and supplement.

(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. Charity care is recorded as a reduction of revenue.

(y) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2006 and 2005, was $711,593 and $898,446, respectively.

(z) Classification of Expenses

		2006	2005
Program activities	$	134,353,149	127,152,098
General and administrative		20,282,621	22,224,758
Change in fair value of interest rate swap		7,700	(379,205)
Loss on extinguishment of debt		—	1,816,514
Fundraising		1,025,102	644,330
	$	155,668,572	151,458,495

(aa) Fundraising Expenses

Fundraising expenses incurred by the Corporation are included in general and administrative on the statement of activities.

(ab) Performance Indicator

The Corporation measures the performance of its operations using the statement of activities and changes in net assets, which includes a performance indicator of operations labeled as "changes in unrestricted net assets before unrealized gains on investments, loss on impairment of assets, (loss) gain on discontinued operations and equity received from tax credit limited partner." Changes in unrestricted net assets which are excluded from this measure are: unrealized gains on investments, loss on impairment of assets, (loss) gain on discontinued operations, equity received from tax credit limited partner and other significant adjustments which do not directly indicate operational performance.

(ac) Statements of Cash Flows

Interest paid during the years ended December 31, 2006 and 2005 was $8,023,092 and $7,332,587, respectively. Interest of $24,740 and $250,465 was capitalized in 2006 and 2005, respectively. Purchases of assets under capital lease arrangements during the year ended December 31, 2006 and 2005 were $312,454 and $117,975, respectively.

(3) Investments

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

		2006		2005	
		Market	Cost	Market	Cost
Certificates of deposit	$	1,042,093	1,041,495	1,904,010	1,909,534
Money market funds		4,416,623	4,416,623	4,175,813	4,175,813
Marketable equity securities		3,602,131	3,405,620	41,152,047	37,595,640
Mutual Funds		58,188,090	54,373,136	2,598,685	1,933,158
Other equity securities		—	—	218,502	237,163
U.S. Government securities		3,200,423	3,234,245	16,155,894	16,413,785
Corporate bonds and notes		7,331,927	6,710,635	15,015,179	15,510,301
Alternate investments		4,465,892	3,724,365	—	—
Other		146,136	146,136	271,408	277,261
Totals	$	82,393,315	77,052,255	81,491,538	78,052,655
Less assets whose use is limited (note 4)		(15,347,650)		(14,968,613)	
Total investments	$	67,045,665		$ 66,522,925	

The Corporation invests in a wide variety of individual fixed income and equity investments including bonds issued by the US Government and it's agencies, corporate bonds, mutual funds, common stocks, certificates of deposit and alternative investments. The Corporation has approximately two hundred thirty five and five hundred fifty one of such individual holdings as of December 31, 2006 and 2005 respectively.

As of December 31, 2006 and 2005, fifty and two hundred four, individual holdings have a market value that has been below cost for less than a year, respectively. For 2006, these are mostly equities and mutual funds and fixed income investments and in total, their market value is less than two percent below cost. For 2005, they are both equity and fixed income investments, and in total, their market value is less than five percent below cost.

Thirty one and one hundred twenty one individual holdings have a market value that has been below cost for more than a year as of December 31, 2006 and 2005 respectively. These are both equity and fixed income funds, and in total, their market value is less than five and six percent below cost for 2006 and 2005, respectively.

(3) Investments (continued)

A summary of investments with fair values below cost as of December 31, 2006 follows:

		Less than 12 Months		More than 12 Months		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	$	1,170,470	(5,185)	1,779,258	(44,892)	2,949,728	(50,077)
Corporate bonds		148,173	(2,489)	—	—	148,173	(2,489)
Subtotal debt securities		1,318,643	(7,674)	1,779,258	(44,892)	3,097,901	(52,566)
Mutual Funds		6,596,730	(110,622)	—	—	6,596,730	(110,622)
Common stocks		109,953	(19,018)	89,587	(53,737)	199,540	(72,755)
Subtotal securities		6,706,683	(129,640)	89,587	(53,737)	6,796,270	(183,377)
Certificates of Deposit		139,690	(310)	217,172	(2,993)	356,862	(3,303)
Total temporarily impaired securites	$	8,165,016	(137,624)	2,086,017	(101,622)	10,251,033	(239,246)

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

		Less than 12 Months		More than 12 Months		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	$	8,255,181	(170,283)	4,827,443	(131,546)	13,082,624	(301,829)
Corporate bonds		4,575,595	(102,348)	2,641,102	(117,642)	7,216,697	(219,990)
Subtotal debt securities		12,830,776	(272,631)	7,468,545	(249,188)	20,299,321	(521,819)
Mutual Funds		363,740	(27)	44,600	(6)	408,340	(33)
Common stocks		9,457,190	(817,180)	977,213	(299,709)	10,434,403	(1,116,889)
Subtotal securities		9,820,930	(817,207)	1,021,813	(299,715)	10,842,743	(1,116,922)
Certificates of Deposit		254,510	(590)	393,992	(6,385)	648,502	(6,975)
Total temporarily impaired securites	$	22,906,216	(1,090,428)	8,884,350	(555,288)	31,790,566	(1,645,716)

(4) Assets Whose Use is Limited

At December 31 assets whose use is limited which are carried at market value consisted of the following:

		2006	2005
Permanently restricted investments	$	4,122,715	3,655,924
Debt service reserve funds		7,597,624	7,403,054
Operating reserve fund		1,438,394	1,229,344
Bond funds		1,016,644	1,668,622
Assets designated to renovation and charity care		633,127	546,004
Other reserves required under financing arrangements		539,146	465,665
		15,347,650	14,968,613
Less current portion		(1,649,771)	(2,039,862)
	$	13,697,879	12,928,751

(5) Related Party Transactions

Prelude Systems, Inc. (Prelude), is a joint venture between the Corporation 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 PHI and Diakon as well as other healthcare and community service organizations. PHI's investment in Prelude is included in investments in marketable equity securities as of December 31, 2006 and 2005. During 2006 and 2005, respectively, PHI paid Prelude approximately $1,936,000 and $1,660,000 for information services provided by Prelude.

In addition, the Corporation's affiliates purchase medications from Continuing Care Rx Holding Company, Inc. As of December 29, 2004 the Corporation sold its majority interesting Continuing Care Rx, Inc. and remains a minority shareholder. Total purchases by affiliates from Continuing Care Rx Holding Company, Inc. for 2006 and 2005 were approximately $2,871,958 and $2,352,760, respectively, of which $589,591 and $447,334 is included in accounts payable as of December 31, 2006 and 2005, respectively.

In September 2004, PHI invested in Alliance Rehab HVA, L.L.C., obtaining a ten percent ownership in the limited liability company. Alliance Rehab HVA, L.L.C. operates a post acute rehabilitation delivery system and senior fitness programs primarily directed at nursing homes, assisted living facilities, independent living facilities, home healthcare care provider, and community and fitness centers. PHI's investment in Alliance Rehab HVA, L.L.C. is included in investments in marketable equity securities as of December 31, 2005. The Corporation received $94,000 in dividends from Alliance Rehab in 2005. In May 2006, PHI redeemed its membership interest in Alliance Rehab HVA, LLC. During 2006 and 2005, the Corporation purchased services from Alliance Rehab for $2,968,043 and $3,581,738, respectively, of which $733,459 and $635,136 is included in accounts payable as of December 31, 2006 and 2005, respectively.

(6) Property and Equipment

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

	2006	2005
Land	$ 27,056,847	24,458,555
Land improvements	19,503,231	19,288,171
Buildings and improvements	264,487,449	250,893,877
Building equipment	118,816	114,494
Departmental equipment, furniture and fixtures	40,805,233	40,363,362
Furniture	4,341,960	4,557,455
Vehicles	2,713,397	2,579,299
Construction-in-progress	12,444,565	6,463,876
	371,471,498	348,719,089
Accumulated depreciation	(162,238,195)	(150,967,591)
	$ 209,233,303	197,751,498

As the Corporation undertakes expansion projects 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.

Construction-in-progress consists of construction costs incurred for various renovation and expansion projects at the Corporation's existing facilities.

As of December 31, 2006 and 2005, commitments for future construction totaled approximately $6,910,300 and $6,423,600, respectively.

In October 2005, PHI received an allocation from the Pennsylvania Housing Finance Agency of approximately $6.4 million in tax credits payable over ten years. The credits are to be used for the construction of a fifty unit senior apartment building at a total cost of approximately $8 million which will be rent and income restricted for lower income seniors for a period of 30 years. Schartner House Inc. was organized by the Corporation to be a general partner for this project. The partnership, Schartner House Associates, L.P. (the Partnership) has a general partner, Schartner House Inc, a special limited partner, MMA Special Limited Partner, Inc. and an investor limited partner, MMA Financial Institutional Tax Credits XXI.

During 2006, it was determined that a planned renovation and construction project was not moving forward at QRC and $924,050 of assets were written off as costs associated with abandoned projects.

Additional discontinued operations consist of remaining costs of Presbyterian Health Center which was sold in 2003.

(7) Long-term Debt

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

		2006	2005
Cumberland County Municipal Authority Bonds Series 1993A, principal due in 2018, variable interest rate, 3.94% and 3.55% at December 31, 2006 and 2005, respectively, secured by irrevocable letter of credit with an annual fee of 0.95%, which expires December 15, 2010	$	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 property and equipment and gross revenues of Presbyterian Homes, Inc.		16,060,000	17,175,000
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, 3.92% and 3.5% at December 31, 2006 and 2005, respectively, collateralized by letter of credit with an annual fee of 0.95% which expires on December 15, 2010		8,660,000	8,765,000
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 4.40% and 3.65% at December 31, 2006 and 2005, respectively, collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.		8,340,762	8,898,628
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 property and equipment and gross revenues of Presbyterian Homes, Inc.		16,800,000	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, 3.65% and 4.25 % at December 31, 2006 and 2005, respectively, insured by municipal bond insurance and property and equipment and gross revenues of Presbyterian Homes, Inc.		16,800,000	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	14,045,000

(7) Long-term Debt

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

	2006	2005
Northampton County Industrial Development Authority Series 2002 First Mortgage Revenue Refunding Bonds, principal due in varying annual amounts through 2030, interest adjusted weekly, 3.92% and 3.5% at December 31, 2006 and 2005, respectively, collateralized by a letter of credit	24,505,000	25,595,000
Fannie Mae mortgage payable executed on March 29, 1973, amortization of principal from May 1, 1973 through September 2013, interest rate of 7% effective rate of 0% in 2003 due to FHA subsidy	690,850	774,635
HUD Flexible Subsidy Loans payable, principal balance due upon sale of the project building or upon full payment of the HUD mortgage, simple interest of 1% payable at time of principal payments	1,672,491	1,672,491
Mortgage payable for building loan provided by HUD, monthly installments of principal and interest, interest rate of 3%	993,208	1,059,530
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999A, tax exempt variable rate debenture bonds, principal maturities in varying amounts from 2012 to 2029, interest adjusted weekly 3.93% and 3.35% at December 31, 2006 and 2005, respectively, collateralized by letter of credit	3,340,000	3,340,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999B, taxable variable rate debenture bonds, principal maturities in varying amounts from 2001 to 2029, interest adjusted weekly 5.35% and 4.37% at December 31, 2006 and 2005, respectively, collateralized by letter of credit	15,410,000	15,740,000
Term Loan with S&T Bank, bearing interest at a variable rate of 8.25% and 7.25% at December 31, 2006 and 2005, repectively, principal and interest payments due monthly, collateralized by property and equipment of corporate office of PHI	585,918	796,987
Term Loan with S&T Bank, bearing interest at a variable rate of 7.07% at December 31, 2005, principal and interest payments due monthly collateralized by Dillsburg property of PHI	-	419,296
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, 2006 and 2005. The note is collateralized by certain receivables and property at Westminster Woods	3,145,574	3,291,353

(7) Long-term Debt (continued)

	2006	2005
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 3.96% and 3.75% at December 31, 2006 and 2005, respectively. These bonds are collateralized by all or portions of the following facilties: Westminster Woods, Woodland Retirement Center, and Hollidaysburg Home	8,010,000	8,545,000
Series 2002 Huntingdon County Industrial Development Authority, Mortgage Revenue Note, payable in equal monthly installments of principal and and interest sufficient to amortize the principal balance to April 2023. The note bears a floating interest rate, which was 5.29% and 2.69% at December 31, 2006 and 2005, respectively. The note is collateralized by a second lien position on the Westminster Woods facility.	859,663	894,931
Series 2005 College Township Revenue Bonds, payable in equal installments of $25,248 per month to include principal and interest beginning October 2006. The bonds bear a floating rate of 5.01% and 5.04% as of December 31, 2006 and 2005, respectively. The bonds are collateralized by the Windy Hill campus.	3,771,689	2,008,551
Management Services Office ("MSO") mortgage. Payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to June 2023. The note bears interest at a variable rate, which was 5.44% and 3.33% at December 31, 2006 and 2005, respectively. The note is collateralized by the MSO facility.	858,275	896,050
Mortgage note payable, Community Program Loan Trust, payable in monthly installments of $28,126, due August 2014. The note bears an interest rate of 5%, and is collateralized by all property plant and equipment except the ILU assets of QRC.	1,393,746	1,635,615
Mortgage note payable, Waynesboro Borough Authority, payable in monthly installments of $18,255, due January 2025. The note bears an interest rate of 5.36% and 4.40%, as of December 31, 2006 and 2005, respectively, and is collateralized by all ILU assets and a second lien on all other property plant and equipment of QRC.	2,733,897	2,823,640
Mortgage note payable, M&T Bank, payable on demand. If no demand is made, payable in monthly installments of $9,090 and due July 2028. The note bears an interest rate of 7.50%. The note is collateralized by a second lien position on the ILU assets, and all other property plant and equipment of QRC.	1,182,446	1,202,588

(Continued)

(7) Long-term Debt (continued)

		2006	2005
Note payable, M&T Bank, is payable on demand. Unless called, payable in monthly installments of principal of $1,200 plus accrued interest and due February 2039. The note bears a variable interest rate of prime plus one percent, 9.25% and 8.25% at December 31, 2005 and 2006, respectively. The note is collateralized by all personal property, fixtures and receivables of QRC.		463,800	478,200
Note payable, John Deere Credit, payable in monthly installments of $374. The note bears an interest rate of 3.80%. The note is collateralized by equipment		22,010	40,380
Presbytery of Huntingdon revolving loan with no interest payable in annual installments of $5,000		20,000	25,000
Other notes and mortgagages, primarily paying interest only as of December 31, 2006; interest rates ranging from 0% to 1% as of December 31, 2006.		117,250	317,250
		156,481,579	160,040,125
Less: Current portion		(6,616,667)	(6,072,612)
Unamortized discount		(414,565)	(436,106)
Plus: Unamortized premium		363,044	493,076
	$	149,813,391	154,024,483

All of the obligations above are collateralized by either property, plant and equipment and gross revenues of the Corporation's consolidated affiliates, or by a letter of credit.

In December 2005, the Corporation issued Cumberland County Municipal Authority Series A and B bonds totaling $33,600,000. The bonds were used to refund the remaining Cumberland County Series 1996 bonds, provide approximately $543,000 for capital improvements, and to pay for issuance and bond insurance costs.

Under the terms of Presbyterian Homes, Inc.'s, PHSC's, PHPH's, QRC's and PSLSI's bond indentures, the Corporations are required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indentures also place limits on additional borrowings and require the Corporations to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants have been met at December 31, 2006 for all the corporations, with the exception of PSLSI and QRC, which obtained waivers from the bank.

The Corporation had outstanding letters of credit of $44,959,000 and $45,862,000 at December 31, 2006 and 2005, respectively as required by certain bonds for PHSC and PSLSI.

(7) Long-term Debt (continued)

Current Maturities of Long-term Debt

Maturities for the five years subsequent to December 31, 2006 and thereafter are as follows:

Years ended December 31,	Aggregate maturities
2007	$ 6,616,667
2008	5,239,051
2009	5,384,991
2010	5,513,657
2010	4,370,742
Thereafter	129,356,471
	$ 156,481,579

In October 2003, Presbyterian Housing and Services Corporation extended its a swap agreement with a new financial intermediary, which fixes the interest rate to be paid by the Corporation on a portion of the 2002 bonds as follows:

Notional Amount	Expiration Date	Interest Rate
$9,200,000	May 1, 2006	2.41%

In September 2003, Presbyterian Homes, Inc. entered into a swap agreement with a financial intermediary, which fixes the interest rate to be paid by Presbyterian Homes, Inc. on a portion of the Kent County 2003 bonds as follows:

Notional Amount	Expiration Date	Interest Rate
$10,000,000	November 28, 2008	3.39%

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

The Corporation has available various lines of credit with financial institutions. Interest rates on these lines of credit are variable based on the prime rate of the various financial institutions or the LIBOR rate. As of December 31, 2006 and 2005, under the line of credit agreements, the Corporation had available a maximum of $11,400,000 and $9,100,000 from the financial institutions. As of December 31, 2006 and 2005, the Corporation had amounts totaling $7,303,290 and $3,309,437 outstanding under these agreements at interest rates ranging from 6.75% to 8.25%.

(9) Leases

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

		2006	2005
Medical and office equipment	$	511,038	198,943
Accumulated amortization		(134,662)	(42,409)
	$	376,376	156,534

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, 2006 follows:

2007	$	185,934
2008		177,007
2009		44,902
		407,843
Amounts representing interest		(28,689)
	$	379,154

(9) Leases (continued)

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

2007	$ 256,213
2008	173,373
2009	78,423
2010	9,051
2011	4,687
	$ 521,747

Rental expense under operating leases was $422,530 and $742,271 for the years ended December 31, 2006 and 2005, 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. Total annuities payable were $1,170,510 and $1,201,219 at December 31, 2006 and 2005, respectively. The Corporation uses published mortality rate tables adopted by the Internal Revenue Service and an assumed discount rate of approximately 4% to 6% to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of $1,617,686 and $1,553,391 as of December 31, 2006 and 2005, respectively to satisfy annuities.

(11) Workers' Compensation Insurance

The Corporation has a self-insured Workers' Compensation program as allowed by the Commonwealth of Pennsylvania and the State of Delaware Bureau 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. In 2005, the Corporation maintained a letter of credit for $2.3 million in connection with this self-insurance program, and a restricted investment account in the amount of $1,951,370. In 2006, the Corporation maintains a restricted investment account in the amount of $2,414,724 as collateral for this self-insurance program. At December 31, 2006 and 2005, the Corporation has recorded an accrued expense of approximately $4.23 million and $4.05 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:

		2006	2005
Purchase of buildings and equipment	$	4,091	4,091
Educational		67,073	58,417
Beneficial interest in assets of PHI		1,167,758	893,505
Charity care and/or equipment, including pledges receivable		1,477,003	1,279,647
Assets held in charitable trust for charity care		780,679	856,286
Various resident activities		112,963	186,076
	$	3,609,567	3,278,022

Net assets of $951,429 and $1,102,629 were released from restriction during 2006 and 2005 respectively in satisfaction of the above restrictions.

(13) Permanently Restricted Net Assets

Permanently restricted net assets are allocated to the following purposes at December 31:

		2006	2005
Charity care/equipment	$	4,375,354	3,836,114
Beneficial interest in assets of PHI		830,086	830,086
Contribution recievable from remainder trust		1,303,256	—
Educational		9,597	9,597
Perpetual trusts, income restricted for charity care		12,704,757	11,934,862
	$	19,223,050	16,610,659

(14) 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 $11.6 and $9.8 million for the years ended December 31, 2006 and 2005, respectively, of which the amount of charges foregone for services and supplies was approximately $2,070,000 and $1,998,000, respectively.

(Continued)

(15) Retirement Plan

The Corporation has a defined-contribution retirement plan covering all employees that have completed one year of service and have reached the age of 21. Vesting occurs after three years of service. Contributions to the plan are at the discretion of the Board of Trustees of PHI and employees have the ability to direct how their contributions are invested. For the years ended December 31, 2006 and 2005, retirement plan expense totaled approximately $1,134,000 and $1,496,000, respectively.

QRC has a defined benefit pension plan covering substantially all employees. This plans 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 Corporation'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.

A comparison of accumulated plan benefits and plan net assets for the Corporation's defined benefit plan consists of the following as of December 31, 2006:

Obligations and Funded Status:		2006	2005
Change in Benefit Obligation:			
Project benefit obligation - beginning of year	$	(2,914,615)	(3,514,370)
Interest cost		(159,230)	(194,846)
Distributions		368,669	846,030
Change due to assumptions as of end of year		126,003	(153,134)
Experience loss as of beginning of year		(9,369)	101,705
Projected benefit obligation - end of year	$	(2,588,542)	(2,914,615)
Change in Plan Assets:			
Fair value of plan assets - beginning of year	$	2,275,816	2,930,756
Actual return on plan assets		249,414	154,954
Contributions		181,000	82,500
Benefits Paid		(420,364)	(884,139)
Projected benefit obligation - end of year	$	2,285,866	2,284,071
Funded Status		(302,676)	(630,544)
Unrecognized net transition asset	$	–	–
Unrecognized net loss		304,380	537,055
Unrecognized prior service cost		–	–
Minimum pension liability adjustment in equity		(304,380)	(537,055)
Accrued Pension Liability, Net	$	(302,676)	(630,544)

(12) Retirement Plan (continued)

As Presented on Consolidated Balance Sheet:		2006	2005
Intangible asset - pension plan	$	–	–
Minimum pension liability		(302,676)	(630,544)
Accrued Pension Liability, Net	$	(302,676)	(630,544)

The accumulated benefit obligation amounted to $2,588,542 and $2,914,615 as of December 31, 2006 and December 31, 2005, respectively.

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

		2006	2005
Service cost	$	51,695	35,955
Interest cost		159,230	194,846
Expected return on plan assets		(186,993)	(235,390)
Amortiztion of unrecognized net loss		21,857	10,281
Net Periodic Pension Expense	$	45,789	5,692

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, 2006:

Discount rate	5.8%
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-year time horizon. Specifically, investment returns for the pension fund were projected over a 10-year period using varying equity allocations.

(Continued)

(12) Retirement Plan (continued)

The pension plan assets were invested and allocated in the following manner as of December 31, 2006:

Equity securities	46.4%
Debt securitieis	45.8%
Other	7.8%

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

2007	56,764
2008	63,327
2009	71,821
2010	82,340
2011	95,387
2012-2015	638,068

The Corporation is not required and therefore, does not expect to contribute to the pension plan during the year ending December 31, 2007.

Starting in 2007, QRC's plan will be merged into the Corporation's.

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

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

Investments: The fair values of U.S. Government securities, notes, corporate bonds and equity securities and mutual funds are estimated based on quoted market prices for those or similar investments. Alternative investments – limited partnerships are valued as described in Note 2(j).

(Continued)

(17) Financial Instruments (continued)

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

The Corporation has a number of other financial instruments, none of which are held for investment purposes. The Corporation estimates that the fair value of all financial instruments at December 31, 2006 and 2005 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statement of financial position.

(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 as disclosed in the notes.