

**The Highlands at
Wyomissing**
Financial Statements
June 30, 2009 and 2008

The Highlands at Wyomissing

Index

June 30, 2009 and 2008

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Report of Independent Auditors

To the Board of Directors
The Highlands at Wyomissing

In our opinion, the accompanying balance sheets and the related statements of operations, changes in net assets, and cash flows present fairly, in all material respects, the financial position of The Highlands at Wyomissing ("Highlands") as of June 30, 2009 and 2008, and the results of its operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Highlands' management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

October 9, 2009

The Highlands at Wyomissing
Balance Sheets
June 30, 2009 and 2008

	2009	2008
Assets		
Cash and cash equivalents	\$ 3,577,055	\$ 1,197,700
Investments, at fair value	20,677,141	29,360,172
Accounts receivable, residential fees	1,538,763	851,959
Patient accounts receivable, less allowance for uncollectible accounts of \$15,000 and \$20,000 as of June 30, 2009 and 2008, respectively	410,714	533,109
Other receivables	22,691	47,881
Inventory	227,415	250,913
Prepaid expenses	195,475	189,822
Total current assets	<u>26,649,254</u>	<u>32,431,556</u>
Assets whose use is limited		
By board for endowment fund	4,806,804	5,674,569
By board for capital improvements	3,762,604	3,656,854
Under debt agreements - held by trustee	2	27
Under unemployment compensation funding arrangement	27,243	27,243
Under workers' compensation funding arrangement - held by trustee	150,759	151,964
Under regulatory requirements	3,273,288	4,607,971
For use other than current operations	11,000	11,000
Property and equipment, net	43,070,004	40,560,172
Bond financing costs, net	488,238	530,014
Initial contract costs, net	4,379	4,379
Total assets	<u>\$ 82,243,575</u>	<u>\$ 87,655,749</u>
Liabilities and Net Assets		
Current portion of long-term debt	\$ 2,540,000	\$ 2,465,000
Accounts payable	3,589,242	1,144,173
Refundable fees, current	850,417	343,218
Accrued interest	499,873	556,659
Other accrued expenses	1,614,810	1,707,436
Current portion of gift annuities	150,772	148,822
Total current liabilities	<u>9,245,114</u>	<u>6,365,308</u>
Swap contracts	4,630,098	3,131,988
Deferred entrance fee revenue	13,788,398	12,714,079
Refundable fees, net of current portion	20,422,313	19,024,603
Gift annuities, net of current portion	614,797	652,313
Long-term debt, net of current portion	36,870,000	39,410,000
Total liabilities	<u>85,570,720</u>	<u>81,298,291</u>
Net assets		
Unrestricted	(3,346,935)	6,338,082
Temporarily restricted	19,790	19,376
Net assets	<u>(3,327,145)</u>	<u>6,357,458</u>
Total liabilities and net assets	<u>\$ 82,243,575</u>	<u>\$ 87,655,749</u>

The accompanying notes are an integral part of these financial statements.

The Highlands at Wyomissing
Statements of Operations
Years Ended June 30, 2009 and 2008

	2009	2008
Revenue, gains, and other support		
Residential services, including amortization of entrance fees of \$3,373,760 and \$3,832,334 for the years ended June 30, 2009 and 2008, respectively	\$ 14,810,452	\$ 14,590,844
Net patient service revenue	5,517,384	4,943,578
Investment (loss) income	(5,771,271)	2,084,318
Other income	691,457	805,042
Net assets released from restrictions for operations	8,556	19,820
Total revenue, gains, and other support	<u>15,256,578</u>	<u>22,443,602</u>
Expenses		
General and administrative	2,144,494	2,109,840
Marketing	301,812	335,466
Support services	3,272,620	3,245,586
Food service	3,610,482	3,541,516
Health care	5,658,452	5,203,469
Utilities	885,873	965,011
Real estate taxes	1,108,310	1,066,603
Depreciation and amortization	2,422,870	2,385,220
Interest expense	1,677,662	2,314,867
Total expenses	<u>21,082,575</u>	<u>21,167,578</u>
Operating (loss) income	(5,825,997)	1,276,024
Nonoperating income		
Realized and unrealized losses on swap contracts	<u>(2,826,388)</u>	<u>(2,349,519)</u>
Deficiency of revenue over expenses	(8,652,385)	(1,073,495)
Change in unrealized losses on investments	<u>(1,032,632)</u>	<u>(4,934,032)</u>
Change in unrestricted net assets	<u>\$ (9,685,017)</u>	<u>\$ (6,007,527)</u>

The accompanying notes are an integral part of these financial statements.

The Highlands at Wyomissing
Statements of Changes in Net Assets
Years Ended June 30, 2009 and 2008

	2009	2008
Unrestricted net assets		
Deficiency of revenue over expenses	\$ (8,652,385)	\$ (1,073,495)
Change in unrealized losses on investments	<u>(1,032,632)</u>	<u>(4,934,032)</u>
Change in unrestricted net assets	<u>(9,685,017)</u>	<u>(6,007,527)</u>
Temporarily restricted net assets		
Contributions received	8,970	23,305
Net assets released for operations	<u>(8,556)</u>	<u>(19,820)</u>
Change in temporarily restricted net assets	<u>414</u>	<u>3,485</u>
Change in net assets	(9,684,603)	(6,004,042)
Net assets		
Beginning of year	<u>6,357,458</u>	<u>12,361,500</u>
End of year	<u>\$ (3,327,145)</u>	<u>\$ 6,357,458</u>

The accompanying notes are an integral part of these financial statements.

The Highlands at Wyomissing
Statements of Cash Flows
Years Ended June 30, 2009 and 2008

	2009	2008
Cash flows from operating activities		
Change in net assets	\$ (9,684,603)	\$ (6,004,042)
Adjustments to reconcile to net cash provided by operating activities		
Change in fair value of derivative instruments	1,498,110	1,697,679
Change in unrealized losses on investments	1,032,632	4,934,032
Proceeds from entrance fees and deposits	6,923,880	4,994,480
Amortization of entrance fees	(3,373,760)	(3,382,334)
Utilization of health fund	(674,179)	(828,366)
Depreciation and amortization	2,422,870	2,385,220
Provision for uncollectible accounts	38,923	205,828
Realized loss (gain) on investments	2,418,518	(3,144,193)
Other than temporary impairment of investments	4,276,196	2,219,153
Loss on sale of assets	31,004	31,991
Restricted contributions received	(8,970)	(23,305)
Changes in cash due to changes in operating assets and liabilities		
Residential, patient and other accounts receivables, net	78,988	(1,676)
Other current assets	43,035	(13,826)
Accounts payable and other accrued expenses	1,269,979	805,778
Net cash provided by operating activities	<u>6,292,623</u>	<u>3,876,419</u>
Cash flows from investing activities		
Acquisition of property, plant and equipment	(3,896,251)	(1,329,732)
Purchase and sales of assets whose use is limited	1,230	82,335
Proceeds from sales and maturities of investments	10,546,454	22,371,469
Purchase of investments	<u>(7,494,071)</u>	<u>(21,641,920)</u>
Net cash used in investing activities	<u>(842,638)</u>	<u>(517,848)</u>
Cash flows from financing activities		
Refunds of entrance fees and deposits	(579,034)	(770,365)
Payment of long-term debt	(2,465,000)	(2,285,000)
Increase in gift annuities	(35,566)	76,663
Proceeds from restricted contributions	8,970	23,305
Net cash used in financing activities	<u>(3,070,630)</u>	<u>(2,955,397)</u>
Net increase in cash	2,379,355	403,174
Cash and cash equivalents		
Beginning of year	<u>1,197,700</u>	<u>794,526</u>
End of year	<u>\$ 3,577,055</u>	<u>\$ 1,197,700</u>

Supplemental disclosures of cash flows information

Cash paid for interest for the years ended June 30, 2009 and 2008 was \$2,957,791 and \$2,873,051, respectively.

Amounts included in accounts payable for purchases of property, plant and equipment were \$1,025,678 at June 30, 2009. There were no amounts at June 30, 2008.

The accompanying notes are an integral part of these financial statements.

The Highlands at Wyomissing

Notes to Financial Statements

June 30, 2009 and 2008

1. Organization and Operations

The Highlands at Wyomissing ("Highlands"), a nonprofit corporation, is a joint venture between The Reading Hospital ("Hospital") and the Lutheran Home at Topton ("Topton"). The purpose of the Highlands is to operate a continuing care retirement community including residential, recreational, and health care facilities and services specially designed to meet the physical, social, and psychological needs of elderly persons. The Highlands facility is located in Wyomissing, Pennsylvania and its residents are principally from the Wyomissing and Reading, Pennsylvania area. The facility contains 279 residential living units, an 80-bed skilled nursing unit and 70 personal care units.

Certain members of the board of directors from the Hospital and Topton are also members of the board of directors of the Highlands.

Another related party is The Reading Hospital and Medical Center ("Medical Center"), a controlled entity of the Hospital. The Medical Center is a tax-exempt, acute and post-acute care hospital.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less when purchased, excluding amounts whose use is limited by debt agreements and self-insurance trust agreements.

Investments and Investment Income

In September 2006, The Financial Accounting Standards Board ("FASB") released two statements related to fair value accounting. Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("FAS 157") defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("FAS 159") allows the option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements. The fair value option established by FAS 159 permits the Highlands to elect to measure eligible items at fair value on an instrument-by-instrument basis and then report the unrealized gains and losses for those items in the Highlands' deficiency of revenue over expenses. The Highlands adopted FAS 157 as of July 1, 2008. The Highlands did not elect to record any items at fair value under FAS 159.

Under FAS 157, the Highlands is required to categorize and disclose certain assets and liabilities, including investments, at fair value, according to three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

FAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There was no cumulative effect adjustment to net assets as a result of adoption.

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Notes to Financial Statements

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The following is a description of the Highlands' valuation methodologies for investments carried at fair value. These methods may produce a fair value calculation that may not be reflective of future fair values. Furthermore, while the Highlands believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of investments could result in a different estimate of fair value at the reporting date.

Where quoted prices are available in an active market, investments are classified in Level 1 of the valuation hierarchy. Investments in Level 1 are exchange-trade equity securities, mutual funds, and debt securities. If quoted prices are not available, other accepted valuation methodologies, such as quotes for similar securities are used. These valuations services estimate fair values using pricing models and other accepted valuation methodologies, such as quotes for similar securities and observable yield curves and spreads. As part of the Highlands' overall valuation process, management evaluates these third-party methodologies to ensure that they are representative of exit prices in the Highlands' principal markets. Investments in Level 2 include corporate obligations, international equity funds, and time deposits. There are no Level 3 investments as of June 30, 2009. See Note 5 for additional details related to the Highlands' investments.

The Highlands recognizes other than temporary impairment on investments on an annual basis.

Accounts Receivable, Residential Fees

Accounts receivable, residential fees, consist primarily of entrance fees receivable. Entrance fees receivable are recorded when a purchaser signs a contract and deposits 10% of the purchase price of a residential living unit with the Highlands. These receivables are collected prior to the resident's taking occupancy of the residential living unit.

Inventory

Inventory is stated at lower of cost (first-in, first-out method) or market.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method based on the estimated useful lives of each class of depreciable assets. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is expensed as incurred; significant renewals and betterments are capitalized.

Bond Financing Costs

Bond financing costs, representing costs of bond issuance and financing expenses, are being amortized from the date of issue over the period that the bonds are outstanding using the interest method.

Initial Contract Costs

Initial contract costs, which consist primarily of advertising costs incurred in the initial selling phase of residential living units through the first year of operations, are capitalized and amortized using the straight-line basis. Costs relating to the cottages and assisted living units are being amortized over twelve and five years, respectively.

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Notes to Financial Statements

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Gift Annuities

The Highlands receives assets from donors in exchange for the promise to make fixed payments, over a specified period of time, to a recipient as designated by the donor. The Highlands discounts the liability for annuity contracts based on the annuitant's estimated life expectancy. The Highlands revalues the liability for annuity contracts quarterly and the related change is included in other income.

Assets Whose Use is Limited

Assets whose use is limited includes amounts held by trustee required under debt agreements and under a workers' compensation funding arrangement. Funds held by trustee consist primarily of short-term investments and U.S. Government obligations carried at cost, which approximates market value. Assets whose use is limited also includes amounts held under an unemployment compensation funding arrangement, by board for capital improvements and under regulatory requirements. Assets designated by the board of directors for the endowment fund are unrestricted contributions received by the Highlands. They consist primarily of mutual funds carried at quoted market prices.

Operating (Loss) Income

The statements of operations include operating (loss) income. Changes in unrestricted net assets which are excluded from operating income, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction are to be used for the purposes of acquiring such assets), changes in unrealized gains and losses on investments and hedging activity.

Deficiency of Revenue over Expenses

The Statements of Operations include deficiency of revenues over expenses. Changes in unrestricted net assets which are excluded from deficiency of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, certain pension related transactions, the cumulative effect of a change in accounting principle and any assets acquired using contributions which by donor restrictions were to be used for the purpose of acquiring such assets.

Entrance Fees

Refundable Portion

Entrance fees are refundable for a period of time up to 50 months before they are transferred to deferred entrance fee revenue. The refundable portion of entrance fees at June 30, 2009 and 2008 are as follows:

	2009	2008
Basic/entrance	\$ 14,450,734	\$ 11,700,154
Health fund	6,821,996	7,667,667
	<u>21,272,730</u>	<u>19,367,821</u>
Less: Current portion	850,417	343,218
	<u>\$ 20,422,313</u>	<u>\$ 19,024,603</u>

Entrance fees, as noted above, previously included both a basic portion and a health fund portion. For all contracts entered into subsequent to January 1, 2005, the contract states that the entrance fee shall be amortized at the rate of 2% per month for 50 months beginning with the date of occupancy. There is no health fund component.

The Highlands at Wyomissing

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For all contracts entered into prior to January 1, 2005, a portion of the entrance fee, referred to as the health fund, equal to 30% of the total entrance fee, is reserved by the Highlands to be accounted for individually for each resident. The contract states that the health fund will be charged for health care costs limited to the incremental difference between the daily rate for routine service in the Nursing Center (semi-private rate) or in the Assisted Living (studio rate), and the monthly fee prorated on a daily basis in the individual's residence. To the extent the health care needs of a resident exceed the balance of the health fund, such costs will be paid from the general funds of the Highlands. The balance of the entrance fee, basic fund, equal to 70% of the total entrance fee, will be amortized at a rate of 2% per month for 50 months beginning with the date of occupancy.

In either contract mentioned above, if a resident withdraws from the community either voluntarily or by death during the 50 month amortization period, the unamortized amount of the applicable basic/entrance fee and the unused portion of the health fund would be refundable to the resident. The refund would be payable after receipt of the full entrance fee from a new resident.

Deferred Entrance Fee Revenue

Basic entrance fees which are no longer refundable are recorded as deferred entrance fee revenue and are amortized to income using the straight-line method over the estimated remaining life expectancy of the resident. The period of amortization is adjusted annually based on published mortality tables estimating the remaining life expectancy of the residents. Entrance fees also include deposits for future residents of \$449,750 and \$563,450 at June 30, 2009 and 2008, respectively.

Third-Party Agreements

The Highlands is reimbursed at published charges by contract residents and self-pay (noncontract) residents for services rendered. Additionally, the Highlands is reimbursed by third parties for skilled nursing services provided to Medicare-qualified recipients in the skilled nursing unit.

Traditional Medicare reimburses the Highlands under the Prospective Payment System for Part A services and either a percentage of charges or a fee schedule amount for Part B services. Medigap and Supplemental Insurers reimburse the Highlands for deductibles and co-insurance amounts.

Obligation to Provide Future Services

The Highlands annually calculates the present value of the estimated net cost of future services and use of facilities to be provided to current residents and compares that amount with the balance of deferred entrance fee revenue. If the present value of the net cost of future services and use of facilities exceeds the deferred revenue, a liability is recorded with the corresponding charge to income. As of June 30, 2009 and 2008, the estimated present value of the net cost of future services and use of facilities is less than the deferred entrance fee revenue; thus, no liability has been recorded.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose.

Tax Status

The Highlands is a Pennsylvania nonprofit corporation which has been ruled by the Internal Revenue Service to be exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

The Highlands at Wyomissing

Notes to Financial Statements

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The Highlands adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), which requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in an unrelated business activity tax return and disclosures regarding uncertainties in tax positions. After review, it was determined that no adjustments to the financial statements were required as a result of the implementation of FIN 48.

Fair Value of Financial Instruments

The following methods and assumptions were used by the Highlands in estimating its fair value disclosures for financial instruments:

- **Cash and cash equivalents and receivables:** The carrying amounts reported in the balance sheets at June 30, 2009 and 2008 for cash and cash equivalents and receivables approximates their fair market values.
- **Swap contracts:** The fair value of swap contracts are estimated based on quotes from the market makers of the instrument and represent the estimated amount that the Highlands would expect to receive or pay to terminate the agreement at the reporting date.
- **Long-term debt:** The fair values of the Highlands' long-term debt are estimated using discounted cash flow analyses based on the Highlands' current incremental borrowing rates for similar types of borrowing arrangements. The estimated fair value of the Highlands' variable rate long-term debt at June 30, 2009 and 2008 approximated its carrying value. The fair market value of fixed rate long-term debt is disclosed in Note 5.
- **Accounts payable and accrued expenses:** The carrying amount reported in the balance sheet at June 30, 2009 and 2008 for accounts payable and accrued expenses approximates its fair value.

Use of Estimates

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

Derivative Instruments

The Highlands accounts for derivative financial instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133"). SFAS 133, as amended, requires that all derivative instruments be recorded on the balance sheet at fair value as either assets or liabilities. Since the derivatives entered into by the Highlands do not qualify for hedge accounting, changes in fair value of the derivatives are recognized in nonoperating income.

The Highlands uses derivative financial instruments principally to manage the risk that changes in interest rates will affect the amount of its future interest.

The Highlands at Wyomissing

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Recently Issued Accounting Pronouncements

In March 2008, the FASB issues FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ("FAS 161"). FAS 161 changes the disclosure requirements for derivative instruments and hedging activities. FAS 161 requires disclosures on how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect the company's financial position, financial performance, and cash flows. FAS 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008. The use of derivatives by the Highlands is generally limited to interest rate swaps. See Note 6, Derivative Instruments, for these disclosures.

3. Investments

Investments, including assets whose use is limited at June 30, 2009 and 2008 are summarized as follows and are stated at fair value:

	2009	2008
Mutual funds	\$ 18,730,570	\$ 25,768,065
Common stock	1,250,354	2,794,267
Fixed income funds	7,007,582	9,700,771
International equity fund	2,254,352	2,563,006
Cash and money market funds	3,427,740	2,625,448
	<u>\$ 32,670,598</u>	<u>\$ 43,451,557</u>

Included in assets whose use is limited under regulatory requirements are funds required to be maintained under regulations set forth by the Commonwealth of Pennsylvania Department of Insurance. Such funds amounted to \$3,273,288 and \$4,607,971 at June 30, 2009 and 2008, respectively.

Investment income, including interest and dividend income and realized gains (losses) on sales of securities for assets limited to use, cash equivalents and investments, is comprised of the following for the years ended June 30, 2009 and 2008:

	2009	2008
Interest and dividend income	\$ 923,443	\$ 1,159,278
Realized gains on sales of securities	(2,418,518)	3,144,193
Other than temporary impairment of investments	<u>(4,276,196)</u>	<u>(2,219,153)</u>
	<u>\$ (5,771,271)</u>	<u>\$ 2,084,318</u>

The Highlands' investments are managed by an investment advisor and various investment managers. Because the Highlands' investments include a variety of financial instruments, the related values as presented in the financial statements are subject to various market fluctuations which include changes in equity markets, the interest rate environment and general economic conditions.

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The following table represents the fair value measurement levels for all assets and liabilities, which the Highlands has recorded at fair value:

	June 30, 2009	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Mutual funds	\$ 18,730,570	\$ 18,730,570	\$ -	\$ -
Common stock	1,250,354	1,250,354	-	-
Fixed income funds	7,007,582	131,078	6,876,504	-
International equity fund	2,254,352	-	2,254,352	-
Cash equivalents and time deposits	3,427,740	3,427,740	-	-
	<u>\$ 32,670,598</u>	<u>\$ 23,539,742</u>	<u>\$ 9,130,856</u>	<u>\$ -</u>
Liabilities				
Interest rate swaps	\$ 4,630,098	\$ -	\$ 4,630,098	\$ -

4. Property and Equipment

Property and equipment and related accumulated depreciation at June 30, 2009 and 2008 consist of:

	2009	2008
Land and land improvements	\$ 2,403,614	\$ 2,403,614
Buildings	58,606,608	58,141,177
Major movable equipment	2,406,509	2,302,913
Furniture and fixtures	5,803,582	5,692,807
Construction in progress	4,583,177	434,981
	<u>73,803,490</u>	<u>68,975,492</u>
Less: Accumulated depreciation	<u>(30,733,486)</u>	<u>(28,415,320)</u>
	<u>\$ 43,070,004</u>	<u>\$ 40,560,172</u>

Depreciation expense was \$2,381,094 and \$2,329,065 for the years ended June 30, 2009 and 2008, respectively.

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5. Debt

At June 30, 2009 and 2008, long-term debt consisted of the following:

	2009	2008
Revenue Bonds, Series A and B of 2002, issued by the Berks County Municipal Authority	\$ 19,325,000	\$ 20,590,000
Revenue Bonds, Series of 1998, issued by the Berks County Municipal Authority	985,000	985,000
Revenue Bonds, Series of 1997, issued by the Berks County Municipal Authority	9,000,000	9,300,000
Revenue Bonds, Series of 1992, issued by the Berks County Municipal Authority	<u>10,100,000</u>	<u>11,000,000</u>
	39,410,000	41,875,000
Less: Current maturities	<u>2,540,000</u>	<u>2,465,000</u>
	<u>\$ 36,870,000</u>	<u>\$ 39,410,000</u>

Maturity requirements on long-term debt are as follows for the years ending June 30:

2009	\$ 2,540,000
2010	2,825,000
2011	2,910,000
2012	3,000,000
2013	3,105,000
Thereafter	<u>25,030,000</u>
	<u>\$ 39,410,000</u>

On February 7, 2002, the Berks County Municipal Authority ("Authority"), issued Revenue Bonds ("2002 Bonds, Series A and B") primarily for the purpose of: (i) the financing of certain capital projects; (ii) the funding of certain necessary reserves; and (iii) the refunding of Highlands Series B Bonds of 1992. Repayment is in annual payments through 2031.

On September 10, 1998, the Authority issued \$55,135,000 of 5.00% Health Care Revenue Bonds ("Pooled Financing Project") Series of 1998 ("1998 Bonds") to make revolving loans to finance (or reimburse prior expenditures for) the cost of buildings, equipment and improvements included in the capital budgets of the Highland's and the Medical Center to pay certain costs incurred in connection with the issuance of the 1998 bonds. The Medical Center's allocable portion of the 1998 Bonds is \$54,150,000, while the Highlands allocable portion is \$985,000. The Highlands mandatory redemption of the 1998 Bonds is scheduled for August 15, 2013. However, the Highlands may elect to reborrow the funds at that time.

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On May 29, 1997, the Authority issued \$11,000,000 of Revenue Bonds Series of 1997 ("1997 Series Bonds") to fund certain capital projects of the Highlands. The 1997 Series Bonds were issued as Short-Term Adjustable Rate Municipal Securities in the Auction mode. The interest rate in the auction mode is reset every 35 days. The 1997 Series Bonds are not subject to mandatory redemption at the resetting of the auction mode interest rate. However, the Bonds may be converted to a fixed rate subject to the conditions of the Bond Indenture. Such a conversion would require a commitment by the Highlands and the Medical Center to purchase the Series A Bonds. The 1997 Series Bonds are subject to optional redemption at the option of the Highlands, in whole or in part, at par value plus accrued interest on any interest payment date. Repayment is in semi-annual payments through 2027.

On May 14, 1992, the Authority issued \$19,200,000, Series A of 1992 ("Series A Bonds"). The Series A Bonds of 1992 were issued as Resetting Municipal Securities in the Auction mode. The interest rate in the auction mode is reset every 35 days. The Series A Bonds are not subject to mandatory redemption at the resetting of the auction mode interest rate. However, the Bonds may be converted to a fixed rate subject to the conditions of the Bond Indenture. Such a conversion would require a commitment by the Highlands and the Hospital to purchase the Series A Bonds.

The Series A Bonds are subject to optional redemption at the option of the Highlands, in whole or in part, on the second business day preceding any interest payment at par value plus accrued interest.

The Highlands granted to the Authority a security interest in substantially all assets and revenues of the Highlands as collateral for its obligation under these indentures.

The stated maturity/redemption dates and interest rates of the 1992, 1997, 1998, and 2002 Bonds at June 30, 2008 are as follows:

Face Amount	Type	Series	Maturity/Redemption	Interest
\$ 5,125,000	Short-Term Adjustable Rate Securities	Series A of 2002	November 1, 2005-2032	4.69%
14,200,000	Short-Term Adjustable Rate Securities	Series B of 2002	October 1, 2004-2017	6.28%
985,000	Term Bonds	Series of 1998	August 15, 2013	5.00%
9,000,000	Short-Term Adjustable Rate Securities	Series of 1997	October 1, 2004-2027	3.61%
10,100,000	Resetting Municipal Securities	Series A of 1992	October 1, 2004-2017	3.40%

The loan agreements relating to the 1992, 1997, 1998 and 2002 Bonds place limits on the incurrence of additional borrowings and require that the Highlands satisfy certain measures of financial performance as long as the bonds are outstanding. The Highlands was in compliance with the covenants at June 30, 2008. The Highlands was in default of the debt service coverage ratio at June 30, 2009. See Note 13, Subsequent Events, for additional information.

The Medical Center is an unconditional guarantor on behalf of the Authority for the 1992, 1997, 1998 and 2002 Bonds. The Highlands pays an annual fee to the Medical Center for its guaranty of an amount based upon a percentage of the outstanding principal. The percentage was 1.50% and .80% as of June 30, 2009 and 2008, respectively. For the years ended June 30, 2009 and 2008, the fees paid to the Medical Center were approximately \$600,000 and \$327,000, respectively.

The Highlands at Wyomissing

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6. Derivative Instruments

On July 1, 2008, the Highlands adopted FAS 161. FAS 161 requires enhanced disclosures about the use of derivative instruments, the accounting for derivatives, and how derivatives impact financial statements to enable investors to better understand their effects on a company's financial position, financial performance, and cash flows. The Highlands has used derivative instruments, such as interest rate swaps, to manage certain interest rate exposures. Derivative instruments are viewed as risk management tools by the Highlands and are not used for trading and speculative purposes.

When quoted market prices are not available, the valuation of derivative instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including interest rate curves and implied volatilities. The estimates of fair value are made by an independent third-party valuation service using a standardized methodology based on observable market inputs. As part of the Highlands' overall valuation process, management evaluates this third-party methodology to ensure that it is representative of exit prices in the principal markets. These future net cash flows, however, are susceptible to change primarily due to fluctuations in interest rates. As a result, the estimated values of these derivatives will change over time as cash is received and paid and also as market conditions change. As these changes take place, they may have a positive or negative impact on estimated valuations. Based on the nature and limited purposes of the derivatives that the Highlands employs, fluctuation in interest rates have had only a modest effect on its results of operations. As such, fluctuations are generally expected to be countered by offsetting changes in income, expense, and/or values of assets and liabilities.

A summary of the related liabilities and statement of operations impact of the swaps at June 30, 2009 and 2008 is as follows:

	Balance Sheets		Statements of Operations	
	2009	2008	2009	2008
2002A Swap	\$ (1,064,110)	\$ (733,371)	\$ (515,505)	\$ (381,013)
2002B Swap	(2,369,087)	(2,128,417)	(926,128)	(840,894)
1997 Swap	(516,027)	(143,612)	(779,245)	(500,019)
1992 Swap	(680,874)	(126,588)	(605,510)	(627,593)
	<u>\$ (4,630,098)</u>	<u>\$ (3,131,988)</u>	<u>\$ (2,826,388)</u>	<u>\$ (2,349,519)</u>

In connection with the 2002 bond issuance, the Highlands entered into two interest rate swap agreements. The swaps effectively convert the variable rate obligation of the Series A and B Bonds to fixed rates of 4.69% and 6.28%, respectively. The fair values of the interest rate swap agreements are the amounts at which they could be settled based on estimates of market rates. The estimated fair value of the liability relating to the swap on the Series A Bonds at June 30, 2009 and 2008 was \$1,064,110 and \$733,371, respectively. The estimated fair value of the liability relating to the swap on the Series B Bonds at June 30, 2009 and 2008 was \$2,369,087 and \$2,128,417, respectively. These liabilities are included in swap contracts on the balance sheets.

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In connection with the 1997 bond issuance, the Highlands entered into an interest rate swap agreement effective May 26, 2005. The swap effectively converts the variable rate obligation of the Bonds to a fixed rate of 3.607%. The fair value of the interest rate swap agreement is the amount at which it could be settled based on estimates of market rates. The estimated fair value of the liability relating to the swap at June 30, 2009 and 2008 was \$516,027 and \$143,612, respectively. This liability is included in swap contracts on the balance sheets.

In connection with the 1992 bond issuance, the Highlands entered into an interest rate swap agreement effective May 26, 2005. The swap effectively converts the variable rate obligation of the Bonds to a fixed rate of 3.397%. The fair value of the interest rate swap agreement is the amount at which it could be settled based on estimates of market rates. The estimated fair value of the liability relating to the swap at June 30, 2009 and 2008 was \$680,874 and \$126,588, respectively. This liability is included in swap contracts on the balance sheets.

7. Retirement Benefits

For the years ended June 30, 2009 and 2008, the Highlands participated in a noncontributory defined benefit pension plan ("Plan") administered by the Hospital for which coverage includes eligible employees of the Hospital and its controlled entities. Pension expense of the Highlands for the years ended June 30, 2009 and 2008 was \$277,500 and \$214,445, respectively.

8. Related Parties

Included in accounts payable due to the Medical Center was approximately \$2,162,000 and \$667,000 for the years ended June 30, 2009 and 2008, respectively.

9. Temporarily Restricted Net Assets

Temporarily restricted net assets available for resident needs were \$19,790 and \$19,376 for the years ended June 30, 2009 and 2008, respectively. The corresponding assets are included in assets whose use is limited.

For the years ended June 30, 2009 and 2008, net assets of \$8,556 and \$19,820 were released from donor restrictions by the Highlands incurring expenses satisfying the restricted purpose.

10. Significant Concentrations of Credit Risk

Financial instruments which potentially subject the Highlands to concentrations of credit risk consist primarily of cash, cash equivalents, investments and receivables. The related values as presented in the financial statements are subject to various market fluctuations which include changes in the interest rate environment and general economic conditions.

The Highland's operations are located in Wyomissing, Pennsylvania. Its primary service area includes Reading, Pennsylvania and the Greater Berks County community. The Highlands grants credit to its residents and other third-party payors, primarily Medicare and various commercial insurance companies.

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11. Insurance Coverages

The Highlands maintains a self-insurance plan for that portion of workers' compensation costs not covered by insurance. The Highlands purchases excess workers' compensation insurance with statutory limits over a self-insured retention of \$350,000 per occurrence. The Highlands has established a trust fund for the payment of workers' compensation benefits, and has an unused irrevocable letter of credit in the amount of \$500,000 to satisfy the requirements for self-insuring such claims.

The Highlands is commercially insured for professional liability claims up to \$1,000,000 per occurrence and \$3,000,000 per annual aggregate. The Highlands participates in the Mcare Fund (formerly the Medical Professional Liability Catastrophe Fund – "CAT Fund") established under the Medical Care Availability and Reduction of Error Act ("Mcare Act") of the Commonwealth of Pennsylvania ("Commonwealth"), which provides coverage of \$500,000 per occurrence and \$1,500,000 per annual aggregate in excess of the primary coverage.

The actuarially computed liability to all health care providers (hospital, physicians, and others) participating in the Mcare Fund at June 30, 2009 is expected to be substantially in excess of the amount the Mcare Fund has available to pay these claims. The Commonwealth has indicated that the unfunded liability will be funded exclusively through surcharge assessments in future years as claims are settled and paid. No provision has been made for any future Mcare Fund assessments in the accompanying June 30, 2009 financial statements as the Highlands' portion of the Mcare Fund unfunded liability could not be reasonably estimated.

Self-insurance claims reserves at June 30, 2009 and 2008 are summarized as follows:

	2009	2008
Workers' compensation	\$ 181,491	\$ 261,837
Health insurance	216,380	216,380
	<u>\$ 397,871</u>	<u>\$ 478,217</u>

12. Commitments and Contingencies

Laws and regulations governing the Medicare program are complex and subject to interpretation. The Highlands believes that it is in compliance with all applicable laws and regulations through the years ended June 30, 2009 and 2008. Compliance with such laws and regulations can be subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare program.

13. Subsequent Events

The Highlands has evaluated subsequent events through October 9, 2009. Management reviews and identifies subsequent events through participation at meetings of the Board of Directors and its subcommittees.

During July 2009, The Reading Hospital acquired the remaining 50% interest in the Highlands from The Lutheran Home at Topton. This represented a change in control as The Reading Hospital now controls 100% of the Highlands.

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On July 15, 2009, the Highlands borrowed \$38,900,000 in the form of a Promissory Note from The Reading Hospital. The proceeds from this Note were used to repay the existing debt of the Highlands effectively curing the covenant violation at June 30, 2009. This Note is due on August 1, 2039 and bears interest at the Revenue Bond Interest Rate plus 1.50%.