

CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

Asbury Communities, Inc.
Years Ended December 31, 2008 and 2007
With Report of Independent Auditors

Asbury Communities, Inc.

Consolidated Financial Statements and Other Financial Information

Years Ended December 31, 2008 and 2007

Contents

Report of Independent Auditors.....1

Audited Consolidated Financial Statements

Consolidated Balance Sheets2

Consolidated Statements of Operations and Changes in Net Deficit4

Consolidated Statements of Cash Flows.....6

Notes to Consolidated Financial Statements.....8

Other Financial Information

Report of Independent Auditors.....48

Consolidating Balance Sheet49

Consolidating Statement of Operations and Changes in Net Deficit.....51

Report of Independent Auditors

Audit Committee
Asbury Communities, Inc.

We have audited the accompanying consolidated balance sheets of Asbury Communities, Inc. (the Company), formerly known as Asbury Services, Inc., as of December 31, 2008 and 2007, and the related consolidated statements of operations and changes in net deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Asbury Communities, Inc. at December 31, 2008 and 2007, and the consolidated results of their operations and changes in net deficit and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

April 28, 2009

Asbury Communities, Inc.

Consolidated Balance Sheets

	December 31	
	2008	2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 11,268,738	\$ 14,340,222
Investments	35,221,492	53,261,273
Accounts receivable, net of allowance for doubtful accounts of \$2,894,880 and \$1,658,346, respectively	6,666,329	5,784,863
Pledges receivable, net	150,705	200,062
Other receivables and prepaid expenses	8,276,584	8,584,104
Investments held under bond indenture	5,835,634	4,469,922
Total current assets	67,419,482	86,640,446
Property and equipment, net	385,363,196	384,301,211
Investments restricted by donors	16,697,531	23,561,808
Long-term investments	134,192	134,192
Deferred costs, net	15,224,413	15,228,516
Deposits and other assets	455,519	953,883
Other intangible assets, net	3,008,015	3,658,324
Investments held under bond indenture	9,633,751	8,662,321
Statutory reserves	15,417,650	12,722,364
Investments restricted by Board	3,438,781	4,151,776
Pledges receivable, net	-	26,921
Funds held in trust	4,106,650	4,010,429
Total assets	\$ 520,899,180	\$ 544,052,191

	December 31	
	2008	2007
Liabilities and net deficit		
Current liabilities:		
Accounts payable and accrued expenses	\$ 7,548,675	\$ 9,601,842
Accrued compensation and related items	10,067,957	9,640,022
Accrued interest payable	2,807,838	2,827,271
Construction retainage payable	659,590	634,656
Obligations under deferred-giving arrangements	843,878	819,004
Deposits from prospective residents	7,361,007	8,435,178
Entrance fees – refundable	6,908,786	5,966,437
Deferred revenue	388,175	330,026
Current portion of long-term debt	6,005,001	2,260,000
Total current liabilities	<u>42,590,907</u>	<u>40,514,436</u>
Long-term debt, net	320,857,735	313,887,272
Projected refund of standard entrance fees	4,273,528	4,935,352
Entrance fees – deferred revenue	257,268,377	248,668,084
Valuation of derivative instruments	32,014,258	14,782,930
Obligations under deferred-giving arrangements	4,808,595	4,557,569
Other long-term liabilities	326,461	473,010
Total liabilities	<u>662,139,861</u>	<u>627,818,653</u>
Net assets (deficit):		
Unrestricted	(165,335,148)	(107,626,694)
Temporarily restricted	2,139,824	1,865,855
Permanently restricted	21,954,643	21,994,377
Total net deficit	<u>(141,240,681)</u>	<u>(83,766,462)</u>
Total liabilities and net deficit	<u>\$ 520,899,180</u>	<u>\$ 544,052,191</u>

See accompanying notes.

Asbury Communities, Inc.

Consolidated Statements of Operations and Changes in Net Deficit

	Year Ended December 31	
	2008	2007
Revenues, gains and other support:		
Net resident-service revenue	\$ 121,997,824	\$ 114,650,545
Other operating revenue	4,788,707	3,718,737
Amortization of entrance fees	21,010,810	20,051,824
Interest and dividend income, net	1,764,976	3,883,345
Net realized (loss) gain on investments	(62,400)	192,011
Proportionate share of (losses) earnings in equity interests funds	(7,525,487)	2,812,104
Other-than-temporary loss on investments	(19,143,608)	(433,645)
Gain on disposal of fixed assets	-	1,677
Contributions	1,973,497	1,897,153
Net assets released from restrictions used for operations	283,849	678,050
Total revenues, gains and other support	125,088,168	147,451,801
Expenses:		
Salaries	60,742,079	57,791,787
Employee benefits	13,414,797	13,570,060
Cost of goods sold	425,461	-
Contract labor	8,926,345	7,084,114
Food purchases	6,529,763	5,996,914
Medical supplies and other resident costs	5,518,092	5,626,098
General and administrative	7,886,475	8,105,559
Building and maintenance	16,146,368	15,961,005
Professional fees and property insurance	2,163,001	2,309,056
Interest	16,575,310	19,812,581
Taxes	3,015,916	3,110,258
Provisions for bad debts	2,371,854	1,454,317
Depreciation and amortization	20,998,989	20,513,364
Total expenses	164,714,450	161,335,113
Loss from operations prior to net unrealized losses on change in market value of derivative instruments and loss on advance bond refunding	(39,626,282)	(13,883,312)
Net unrealized losses on change in market value of derivative instruments	(17,231,328)	(5,066,875)
Loss on advance bond refunding	-	(18,162,265)
Loss from operations	(56,857,610)	(37,112,452)

(continued)

Asbury Communities, Inc.

Consolidated Statements of Operations and Changes in Net Deficit (continued)

	Year Ended December 31	
	2008	2007
Unrestricted net deficit:		
Loss from operations	\$ (56,857,610)	\$ (37,112,452)
Gain on sale of Reeder's	-	398,416
Loss from discontinued operations	-	(68,057)
Net assets released from restrictions used for purchases of equipment and capital items	106,264	5,000
Net unrealized (loss) gain on investments	(957,108)	328,205
Net increase in unrestricted net deficit	(57,708,454)	(36,448,888)
Temporarily restricted net assets:		
Contributions	664,082	1,450,015
Net assets released from restrictions for operations	(283,849)	(678,050)
Net assets released from restrictions used for purchases of equipment and capital items	(106,264)	(5,000)
Net increase in temporarily restricted net assets	273,969	766,965
Permanently restricted net assets:		
Contributions	562,983	651,254
Changes in value of deferred-giving arrangements	(602,717)	(774,477)
Net decrease in permanently restricted net assets	(39,734)	(123,223)
Changes in net deficit	(57,474,219)	(35,805,146)
Net deficit at beginning of year	(83,766,462)	(47,961,316)
Net deficit at end of year	\$(141,240,681)	\$ (83,766,462)

See accompanying notes.

Asbury Communities, Inc.

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2008	2007
Operating activities		
Changes in net deficit	\$(57,474,219)	\$(35,805,146)
Adjustments to reconcile changes in net deficit to net cash provided by operating activities:		
Provision for bad debts	2,371,854	1,454,317
Depreciation and amortization	20,998,989	20,513,364
Amortization of entrance fees	(21,010,810)	(20,051,824)
Net proceeds from advance fees	17,616,738	14,527,507
Net unrealized loss (gain) on investments	957,108	(328,205)
Other-than-temporary loss on investments	19,143,608	433,645
Proportionate share of losses (earnings) in equity interests funds	7,525,487	(2,812,104)
Net unrealized and realized loss on change in market value of derivatives	17,231,328	5,066,875
Changes in value of obligations under deferred-giving arrangements	602,717	774,477
Gain on sale of Reeder's	-	(398,416)
Loss on disposal of fixed assets	-	1,677
Restricted contributions received	(1,227,065)	(2,101,269)
Transfer from foundation for equipment	(106,264)	(5,000)
Payments for deferred marketing costs	(686,294)	(358,004)
Loss on advance bond refunding	-	18,162,265
Changes in assets and liabilities:		
Accounts receivable	(3,253,320)	(883,246)
Prepaid expenses, deposits and other assets	805,884	5,020,710
Pledges receivable, net	76,278	(42,108)
Deferred revenue	58,149	551,871
Accounts payable and accrued expenses	(1,600,298)	(1,443,209)
Accrued bond interest payable	(19,433)	(91,052)
Net cash provided by operating activities	2,010,437	2,187,125

(continued)

Asbury Communities, Inc.

Consolidated Statements of Cash Flows (continued)

	Year Ended December 31	
	2008	2007
Investing activities		
Purchase of property and equipment	\$(19,941,333)	\$(24,703,199)
Funds held in trust	(96,221)	119,482
Net proceeds from (purchases) sales of investments	(7,041,580)	30,153,463
Transfer from foundation for equipment	106,264	5,000
Purchase of customer related intangibles	(306,500)	-
Proceeds from sale of Reeder's	-	1,673,221
Net cash (used in) provided by investing activities	(27,279,370)	7,247,967
Financing activities		
Proceeds from entrance and advance refundable fees and refundable deposits	25,037,493	22,157,795
Refunds of entrance and advance refundable fees and refundable deposits	(13,836,774)	(11,317,167)
Restricted contributions	1,227,065	2,101,269
Proceeds from issuance of debt	16,750,000	71,000,000
Change in capital lease obligation	(146,549)	-
Payments on long-term debt	(5,950,000)	(82,705,435)
Payments for deferred financing costs	(556,969)	(1,385,121)
Payments on obligations under deferred-giving arrangements	(326,817)	(458,126)
Net cash provided by (used in) financing activities	22,197,449	(606,785)
(Decrease) increase in cash and cash equivalents	(3,071,484)	8,828,307
Cash and cash equivalents at beginning of year	14,340,222	5,511,915
Cash and cash equivalents at end of year	\$ 11,268,738	\$ 14,340,222
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 17,724,321	\$ 20,935,457

See accompanying notes.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements

December 31, 2008

1. Organization

Asbury Communities, Inc. (ACOMM or the Company), formerly known as “Asbury Services, Inc.” was organized on August 1, 1994, as a Maryland not-for-profit organization to provide executive administrative functions, as well as policy and overall planning guidance, to its supported organizations. ACOMM serves as the supporting organization of Asbury Atlantic, Inc. (Asbury Atlantic); Asbury~Solomons, Inc. (A~S); Inverness Village, an Oklahoma not-for-profit Corporation (IV); and Reeders Memorial Home, Inc. (Reeders). ACOMM is the sole voting stockholder of Pivotal Holdings, Inc. (PivH) and The Asbury Group, Inc. (TAG). Additionally, ACOMM is the sole member of Asbury Foundation, Inc. (AFOUND) and Wesley Affiliated Services Foundation, Inc. (WASF).

Asbury Atlantic, Inc. and Subsidiary (Asbury Atlantic) – is a not-for-profit, non-stock corporation organized under the laws of the state of Maryland. Asbury Atlantic has operating segments comprised of Asbury Methodist Village (AMV), Bethany Village (BV), Epworth Manor (EM), and Springhill (SH).

- AMV is a continuing-care retirement community (CCRC) in Gaithersburg, Maryland. A CCRC consists of independent living, assisted living and skilled-nursing units. A CCRC provides a continuum of care that includes housing, healthcare and other related health-care services to seniors.
- BV is a CCRC located in Mechanicsburg, Pennsylvania. Prior to the October 2006 merger, BV was an operating unit of Wesley Affiliated Services (WAS).
- EM is a CCRC located in Tyrone, Pennsylvania. Prior to the October 2006 merger, EM was an operating unit of WAS.
- SH is a CCRC located in Erie, Pennsylvania.

A~S – is a not-for-profit, non-stock corporation organized under the laws of the state of Maryland. A~S is a CCRC located in Solomons, Calvert County, Maryland.

IV – is a not-for-profit, non-stock corporation organized under the laws of the state of Oklahoma. IV is a CCRC located in Tulsa, Oklahoma.

AFOUND – is a not-for-profit, non-stock corporation organized under the laws of the state of Maryland. AFOUND is a supporting organization established to promote charitable giving from available resources to help fund the charitable programs of AMV, A~S, BV, EM, SH, IV and Reeders. ACOMM is the sole member of AFOUND.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization (continued)

WASF – is a not-for-profit, non-stock corporation organized under the laws of the commonwealth of Pennsylvania. *WASF* is a supporting organization that was established to promote charitable giving from available resources to help fund the charitable programs of *BV* and *EM*. In 2008 and 2007, *WASF*'s activity related to collecting and honoring charitable giving, which occurred prior to *AFOUND* serving as a supporting organization for *BV* and *EM*.

PivH – was organized as a for-profit corporation for the purpose of supporting the development of start-up, continuing-care retirement communities. There was no operating activity in *PivH* in 2008 and 2007.

TAG – was organized in 2006 as a for-profit Delaware corporation for the purpose of providing management, marketing, finance and technological support services to both affiliated and nonaffiliated continuing-care retirement communities. *TAG* is a wholly owned subsidiary of *ACOMM*. On July 1, 2008, *TAG* formed *TAG Integrated Technologies, LLC* and *TAG Marketing, LLC* as Delaware limited liability companies.

Reeders – is a not-for-profit, non-stock corporation organized under the laws of the state of Maryland. *Reeders* consisted of skilled-nursing and independent-living units located in Boonsboro, Maryland. In January 2007, substantially all of the assets of *Reeders* were sold by *ACOMM* (see Note 19).

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of *ACOMM* and its affiliates, *Asbury Atlantic*, *A~S*, *Reeders, IV*, *AFOUND*, *WASF*, *PivH* and *TAG* (collectively referred to as the Company). All significant intercompany transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) 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.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include amounts held in checking and savings accounts, money market accounts and short-term certificates of deposit with original maturities of 90 days or less. Cash balances are principally uninsured and subject to normal credit risks.

Accounts Receivable and Contractual Allowances

The Company's policy is to write off all resident accounts that have been identified as uncollectible. An allowance for doubtful accounts is recorded for accounts not yet written off, which are estimated to become uncollectible in future periods.

Under the Medicare and Medicaid reimbursement and other third-party agreements, amounts collected for services to patients under these agreements are computed at contractually agreed-upon rates. Accounts receivable have been adjusted to reflect the difference between charges and the reimbursable amounts under these third-party contracts. Revenues from Medicare and Medicaid programs and other third-party agreements accounted for approximately 16% and 20% of the Company's total net resident service revenues for each of the years ended December 31, 2008 and 2007, respectively.

Pledges Receivable and Fund Held in Trust

Contributions to be received after one year are discounted at an appropriate discounted rate, commensurate with the risks involved. An allowance for uncollectible contributions receivable is provided based on management's judgment, including such factors as prior collection history, type of contribution and nature of fund-raising activity.

Funds held in trust are amounts where the Company does not serve as trustee and amounted to \$4,106,650 and \$4,010,429 as of December 31, 2008 and 2007, respectively. It is the policy of the Company to record such assets only when the Company's interest is deemed to be irrevocable by management and where there is sufficient information to quantify a fair and accurate valuation. The Company's beneficial interest is recorded at the discounted present value of the gift. When the proceeds from these assets are received, the amount received is used for purposes designated by the donor, if any.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Investments and Investment Income

Substantially all investments are held in investment pools with ACOMM. The investment pools comprise mutual funds, common trust funds and private equity funds. The mutual funds have readily determinable market values, and their related unrealized gains or losses are recorded in accordance with Financial Accounting Standards Board (FASB) Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations* (SFAS No. 124). Investments held under bond indenture are high grade income securities. The investments are managed by Russell Investment Group (the Trustee) and are comprised of approximately 82% direct investment in mutual funds, 3% of common trust funds – (ACOMM holds 2% of the fund) – and 15% private equity funds (ACOMM holds less than 1% of each fund).

The common trust funds and private equity funds (collectively referred to as equity interests funds) are accounted for at fair value using the equity method of accounting in accordance with Accounting Principles Board No. 18, *The Equity Method of Accounting for Investments in Common Stock*. Accordingly, the investment return from these funds is included as proportionate share of (losses) earnings in equity interests funds within the loss from operations in the accompanying consolidated statements of operations and changes in net deficit. The financial statements of the equity interests funds are used as a basis for recognizing each affiliate share of investment (losses) earnings that are determined by the Trustee on the basis of market valuations provided by independent pricing services when such prices are believed by the Trustee to reflect the fair value of such securities. If market quotations are not readily available for a security or if subsequent events suggest that a market quotation is not reliable, the funds will use the security's fair value, using consistently applied procedures established by and under the general supervision of the Trustee. This generally means that equity securities and fixed income securities listed and traded principally on any national securities exchange are valued on the basis of the last sale price or, lacking any sales, at the closing bid price, on the primary exchange on which the security is traded. The Trustee may involve subjective judgments as to the fair value of securities. The use of fair value pricing by the funds may cause the net asset value of fund units to differ significantly from the net asset value that would be calculated using current market values. The assets of the underlying real estate mutual funds consist of rental property including apartments, retail, industrial and commercial properties. Accordingly, valuations do not necessarily represent the amounts that might be realized from sales or other dispositions of investments, nor do they reflect taxes or other expenses that might be incurred upon disposition. The real estate investments of the underlying funds have been valued using three basic

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Investments and Investment Income (continued)

approaches: (1) estimate of current cost of reproducing a property less deterioration and functional and economic obsolescence, (2) capitalization of the property's net earning power and (3) value indicated by recent sales of comparable properties in the market. Independent appraisals of real estate investments are periodically obtained. Mortgage loans held by the underlying funds have been valued on the basis of principal and interest payment terms discounted at currently prevailing interest rates for similar investments. Because of the inherent uncertainty of valuations of the investments held by the underlying funds, their estimated values may differ significantly from the values that would have been used had a ready market for these investments existed, and the differences could be material.

Investment returns and related activity are allocated to each affiliate based on their proportion of their underlying holdings. The portion of investments that is available to fund current operating activities is included in current assets in the accompanying consolidated balance sheets. Donated investments are reported at their fair values at date of receipt.

Investment income or loss from mutual funds includes interest and dividends, net of investment management fees; realized gains and losses on investments; and any provision for other-than-temporary impairment of investments. Investment income or loss is included in loss from operations unless restricted by donor or law. In accordance with SFAS No. 124, unrealized gains and losses on investments with readily determinable market values are excluded from loss from operations, unless the losses are deemed to be other-than-temporary.

ACOMM periodically evaluates whether any declines in the fair values of investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to length of time and extent that a security has been in an unrealized loss position, the existence of an event that would impair the issuer's future earnings potential, the near-term prospects for recovery of the market value of a security and the intent and ability of ACOMM to hold the security until the market value recovers. Declines in fair value below cost that are deemed to be other-than-temporary are recorded as realized losses in the accompanying consolidated statements of operations and changes in net deficit.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Derivatives Policy

The Company manages its exposure to interest rate volatility through use of interest rate swap contracts. These contracts qualify as derivative financial instruments.

In accordance with the provisions of American Institute of Certified Public Accountants Statement of Position 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations, and Clarification of the Performance Indicator* (SOP 02-2) the Company applies the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, in the same manner as for-profit enterprises. That is, the gain or loss items related to derivative instruments that affect a for-profit enterprise's income from continuing operations under SFAS No. 133 similarly affect the company's performance indicator, and the gain or loss items that are excluded from a for-profit enterprise's income from continuing operations similarly are excluded from the performance indicator. The Company's performance indicator is referred to as loss from operations. The net amount that becomes due or payable under the contracts is recognized currently in the loss from operations. The book values of the derivative instruments are adjusted to their estimated fair values at each balance sheet date. Under SOP 02-2, to exclude the change in fair value from loss from operations, the derivative instrument must not only be related to a specific bond issue, but must also be a statistically correlated hedge of the current interest cash flow on the bonds. The Company measures the ineffectiveness of the derivative instruments based on the "Hypothetical Derivative Method" in accordance with SFAS No. 133. The measurement of ineffectiveness involves a comparison of the cumulative change in fair value of the hedging instrument and the cumulative change in the fair value of a hypothetical hedge instrument. The Company has determined that the Company's derivatives do not meet the criteria for hedge accounting under SFAS No. 133 and, therefore, the change in fair value of all of the derivative instruments are included within the Company's performance indicator.

Investments Restricted by the Board

Investments restricted by the board include assets set aside by the Board of Directors (the Board) for benevolent care. The Board retains control of these assets and may, at its discretion, subsequently use them for other Board-designated purposes.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost. Donated property and equipment are recorded at fair market value at the date of the gift. Improvements that materially extend the useful lives of the assets are capitalized. General repairs and maintenance costs are expensed as incurred.

Interest costs incurred on borrowed funds and deferred financing costs during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

Deferred Costs

The following is a summary of deferred costs:

	Estimated Life	December 31	
		2008	2007
Deferred marketing costs	Life expectancy of initial residents	\$ 9,116,819	\$ 9,477,734
Deferred financing costs	Term of the bond issue	6,107,594	5,750,782
		<u>\$ 15,224,413</u>	<u>\$ 15,228,516</u>

Direct-marketing costs were associated with acquiring initial residential contracts and are deferred and amortized using the straight-line method over the estimated life expectancy of the initial residents. The amortization expense on deferred marketing costs was \$1,047,209 and \$1,138,799 for the years ended December 31, 2008 and 2007, respectively. Additions to deferred marketing were \$686,294 and \$358,004 for the years ended December 31, 2008 and 2007, respectively.

Deferred financing costs represent expenses (e.g., underwriting, legal, consulting and other costs) incurred in connection with issuance of debt and are deferred and amortized over the life of the related indebtedness on a straight-line basis, which approximates the effective-interest method. In conjunction with issuing the 2008 bonds, the Company recorded deferred financing costs totaling \$480,003. In connection with issuing the 2007 bonds, the Company recorded deferred financing costs totaling \$76,966 and \$1,364,418 as of December 31, 2008 and 2007, respectively. In November 2007, the Company retired its then-existing IV bond obligations. In conjunction with the IV defeasance, the remaining deferred financing costs of \$6,389,783 were written off. The amortization expense on deferred financing costs was \$200,157 and \$387,511 for the years ended December 31, 2008 and 2007, respectively.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Advertising Expenses

The cost of advertising is expensed when incurred and included within the general and administrative financial statement line item within the consolidated statements of operations and changes in net deficit. Advertising expense was \$2,030,294 and \$2,043,967 for the years ended December 31, 2008 and 2007, respectively.

Other Intangible Assets

Other intangible assets of \$3,008,015 and \$3,658,324 as of December 31, 2008 and 2007, respectively, approximate the estimated fair values of the existing resident continuing care contracts, which were acquired, related to the purchase of SH in June 2002, and are being amortized over 10 years. For years 2009 through 2011, the annual amortized expense will be \$813,000 per year. For 2012, the amortized expense will be \$406,324. As of December 31, 2008, the amount also includes \$162,663 related to TAG's purchase of customer contracts and a customer list on March 31, 2008, and are being amortized over one year and three years, respectively. Amortization expense will be \$76,140 in 2009, \$69,219 in 2010 and \$17,304 in 2011.

Deposits from Prospective Residents

Deposits from prospective residents are refundable, less an administrative fee, until such time as the prospective resident executes a residency agreement and pays the balance of the entrance fee. Interest earned on these deposits belongs to the Company, with the exception of IV deposits, whose interest earned belongs to the depositor.

Continuing-Care and Life-Care Contracts

The Company offers continuing-care contracts to its residents. These contracts include residential facilities, meals and other amenities, as well as priority access to long-term nursing care. IV also offers life-care contracts, which include unlimited long-term care in an assisted-living or a skilled-nursing health center at little or no increase in fees.

The Company periodically reviews the present value of the net cost of future services and use of facilities to be provided to current residents under continuing-care contracts and compares that amount with the balance of deferred revenue from entrance fees. IV is required to complete a comprehensive actuarial study every two years. If the present value of the net cost of future services and use of facilities exceeds the deferred revenue from entrance fees, a liability is

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Continuing-Care and Life-Care Contracts (continued)

recorded (obligation to provide future services and use of facilities) with a corresponding charge to income. As a result of this calculation, the present value of the net cost of future services and use of facilities did not exceed deferred revenue from resident entrance fees; accordingly, no obligation was recorded for the years ended December 31, 2008 and 2007.

Revenue Recognition

The Company offers eight types of resident entrance-fee options: three standard nonrefundable options, a 25% refundable option, a 50% refundable option, a 90% refundable option, a 95% refundable option and a 100% refundable option. The options available to the residents vary among AMV, A~S, BV, EM, IV and SH. All resident entrance fees are expected to be paid-in-full upon occupancy. Refunds of entrance fees for termination prior to occupancy are made within 30 days for AMV, A~S, BV, EM and SH, and 120 days for IV.

Under the first standard entrance-fee option, 10% of the fee is nonrefundable upon receipt, and 10% per annum of the entrance fee becomes nonrefundable over a period of nine years. No refund is given upon death during the refund period under the first standard entrance option. Under the second standard entrance fee option, the entrance fee becomes nonrefundable over a period of five years and a refund is provided upon death during the refund period. Under the third standard entrance fee option, 1% per month of the entrance fee becomes nonrefundable over a period of 100 months. Also offered are the 25% refundable, 50% refundable, 90% refundable, 95% refundable and 100% refundable contracts, where residents pay a higher entrance fee in order to guarantee a refund upon receipt of a successor entrance fee for the unit. At IV, the receipt of the successor entrance fee can be for like units but the receipt of successor entrance fees must aggregate to equal the amount of the refund provided. At SH, for contracts dated prior to June 30, 2004, the refund occurs upon the receipt of a successor entrance fee or one year from termination date. Refundable entrance fees are recorded in the accompanying consolidated balance sheets as current liabilities. The nonrefundable entrance fees are classified as deferred revenue and are recognized as revenue on a straight-line basis over each individual resident's expected remaining life.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition (continued)

Remaining life expectancies are determined based on current actuarial data specific to CCRC residents. Under the 25%, 50%, 90%, 95% and 100% refundable contracts, the estimated amount of refundable entrance fees expected to be refunded to current residents upon receipt of a successor entrance fee is recognized as revenue on a straight-line basis over the useful life of the facility. Revenue is not recognized on the refundable entrance fees at BV nor is it recognized on the refundable contracts entered into prior to June 30, 2004, at SH. Upon termination of a contract through death or withdrawal after occupancy, any unamortized, nonrefundable, deferred entrance fee is recorded as income.

The gross amounts of refund obligations are summarized below and are categorized as refundable entrance fees and standard entrance fees. The refundable entrance fees are fixed in their amount but are refundable upon the sooner of the receipt of a successor entrance fee or one year after the resident moves. All of the entrance fees, with the exception of entrance fees received at SH prior to June 30, 2004, require the receipt of a successor entrance fee prior to providing a refund; contracts at SH prior to June 30, 2004, are payable one year after the resident moves out regardless of a successor entrance fee being received. The entrance fees at SH are classified as a current liability. Standard entrance fees are refundable upon termination of occupancy, and the amount of refund is based upon the length of stay in the community.

A summary of net entrance fees is as follows:

	December 31	
	2008	2007
Refundable entrance fees	\$ 6,908,786	\$ 5,966,437
Refundable upon reoccupancy:		
25% to 100% refundable contracts	\$ 152,005,681	\$ 146,874,734
Standard entrance fee option contracts:		
Five-year contracts	95,691,315	94,251,623
Nine-year contracts	13,844,909	12,477,079
Total	261,541,905	253,603,436
Less: projected refund of standard entrance fees	(4,273,528)	(4,935,352)
	\$ 257,268,377	\$ 248,668,084

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition (continued)

The portions of the above entrance fees that continue to be subject to any contractual refund obligation as of December 31, 2008 and 2007, were \$233,764,775 and \$225,275,866, respectively. The Company also records revenue related to resident room and board, which, depending on the facility and contract type, could also include housekeeping, laundry, dining services and future healthcare costs. Revenue for physical, occupational and speech therapy, as well as health personal care and social ancillary charges, is also recorded. Revenue is recognized when services are performed.

Revenue from management and professional services operated with TAG's employees is recognized when services are rendered under management contracts or at the time specific milestones have been reached under development contracts based on the terms of the agreements. The management and professional services revenue is included in other operating revenue.

Charity Care

It is the Company's policy to track those expenses for residents in its facilities who cannot pay for all or a portion of their care, and defines these expenses as charity care. Because the Company does not pursue collection of amounts determined to qualify as charity care, they are not reflected as revenue in the accompanying consolidated financial statements.

Contributions

Unconditional promises to give cash and other assets to the Company are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with contribution-donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net deficit as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated statements of operations and changes in net deficit. Permanently restricted net assets represent donor-restricted endowments to be held in perpetuity.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Temporarily Restricted Net Assets

Temporarily restricted net assets are those that have been limited by donors to a specific time period or purpose. Temporarily restricted net assets are primarily available to purchase equipment, provide charity care and for other health and educational services.

Permanently Restricted Net Assets

Permanently restricted net assets are restricted to investment in perpetuity, the income from which is unrestricted and has been expended to support benevolent care provided by the Company. These assets are pooled with the Company's unrestricted investment portfolio with the objectives of providing long-term growth of capital and maximizing the return on assets over the long-term while diversifying investments within asset classes to reduce the impact of losses in single investments.

A summary of the permanently restricted net assets is as follows:

	December 31	
	2008	2007
Endowment fund, beginning of year	\$ 21,994,377	\$ 22,117,600
Contributions	562,983	651,254
Change in value of deferred-giving arrangements	(602,717)	(774,477)
Endowment fund, end of year	<u>\$ 21,954,643</u>	<u>\$ 21,994,377</u>

Loss from Operations

The accompanying consolidated statements of operations and changes in net deficit include loss from operations. Changes in unrestricted net assets, which are excluded from the loss from operations, consistent with industry practice, include unrealized gains and losses on investments and derivatives (except for investments accounted for under the equity method and derivative instruments that do not qualify for hedge accounting under SFAS No. 133) and permanent transfers of assets to and from affiliates for other than goods and services.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Tax Status

ACOMM and affiliates, except PivH and TAG, are exempt from federal income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code (IRC); accordingly, no provision for income taxes is required.

PivH and TAG are organized as for-profit entities and are subject to federal and state income taxes. Income taxes for PivH and TAG are recorded under SFAS No. 109, *Accounting for Income Taxes*.

The Company has implemented processes to ensure compliance with the Internal Revenue Service intermediate sanctions provisions for all its supported organizations, including the Company. This includes an independent review by the Board's compensation committee of all compensation arrangements with disqualified persons, retention of outside counsel and outside compensation consultants to provide independent third-party review and advisement, and the implementation of a detailed conflict-of-interest policy and annual disclosure process for all disqualified persons.

In June 2006, the FASB issued FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (FIN 48), which became effective as of January 1, 2007. FIN 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the tax benefit from an uncertain tax position must be recognized only if it is more-likely-than-not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The Company's reassessment of its tax positions in accordance with FIN 48 did not have a material impact on the Company's results of operations or financial position.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements under GAAP and is effective for fiscal years beginning after November 15, 2007. SFAS 157 defines fair value, establishes criteria to be considered when measuring fair value and expands disclosures about fair value measurements. SFAS 157 does not expand the application of fair value accounting to any new circumstances.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Fair Value Measurements (continued)

SFAS 157 requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risk inherent in a particular valuation technique (such as a pricing model) and the risks inherent in the inputs to the model.

Recent Pronouncements

The Company adopted SFAS 157 effective January 1, 2008. There was no transition adjustment to beginning retained earnings. SFAS 157 also requires new disclosures regarding the level of pricing observability associated with financial instruments carried at fair value. This additional disclosure is provided in Note 17.

In February 2007, the FASB issued FASB Statement No. 159, *Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* (Statement 159), which permits entities to choose to measure many financial instruments and certain other items at fair value. Statement 159 is effective for fiscal years beginning on or after December 31, 2007. Management has elected not to adopt the provisions of Statement 159.

In August 2008, the FASB issued FASB Staff Position (FSP) 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*, which is intended to improve the quality and consistency of financial reporting of endowments held by not-for-profit organizations. The provisions of this FSP are effective for fiscal years ending after December 15, 2008. The company adopted FSP 117-1 in the year beginning January 1, 2008.

Reclassifications

Certain prior-year amounts have been reclassified to conform to the current-year presentation.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

3. Regulatory Environment

Medicare and Medicaid

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegation of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs.

Medicare Reimbursement

The Balanced Budget Act of 1997 modified how payment is made for Medicare skilled nursing facility (SNF) services. SNFs are reimbursed on the basis of a prospective payment system (PPS). The PPS payment rates are adjusted for case mix and geographic variation in wages and cover all costs of furnishing-covered SNF services (routine, ancillary and capital-related costs).

Maryland Medicaid Reimbursement

Under the Maryland Medical Assistance Program's (Maryland Medicaid) case-mix reimbursement system, the determination of reimbursement rates for nursing costs is based upon a recipient's dependency in activities of daily living and need for the receipt of ancillary nursing services. Final settlements are determined after submission of annual cost reports and audits thereof by the Maryland Medicaid program. The cost reports for 2008 and 2007 estimated Medicaid settlements are subject to verification leading to final settlements.

Pennsylvania Medicaid Reimbursement

The commonwealth of Pennsylvania pays nursing facilities a prospective daily rate for medical assistance residents. The daily rate is set annually based on data in the three most recently filed cost reports. The rate comprises three net operating components (resident care, other resident-related and administrative) and one capital component. The net operating components are based on the facilities' actual net operating costs per day and limited by peer-group ceilings. Resident-care operating costs are adjusted to reflect the acuity level of the facility's residents through a case-mix index. The case-mix index is measured quarterly, and the annual rate is adjusted for any changes on a quarterly basis.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

3. Regulatory Environment (continued)

Medicare and Medicaid (continued)

Pennsylvania Medicaid Reimbursement (continued)

The capital component is based upon the facilities' fair rental value. The daily rate paid to the nursing facility is considered payment in full with no end-of-year settlements.

The commonwealth of Pennsylvania updates payment rates to nursing homes on July 1 of each year. The rates are scheduled to be updated each quarter for the most recent case-mix index for a facility's Pennsylvania Medicaid residents and rebased annually on July 1 of each year.

Other

The Company has implemented a systemwide voluntary compliance program instituted by ACOMM. This program is based on the elements of an effective program identified by the Office of Inspector General of the Department of Health and Human Services. The program includes a dedicated compliance officer, Board of Directors oversight, written policies and procedures, a code of conduct, continuous education, periodic auditing and an associate hotline.

State of Maryland Reserve Requirement

The state of Maryland requires AMV and A~S to set aside reserves equal to 15% of its net operating expenses (as defined) for the most recent fiscal year. As of December 31, 2008, AMV and A~S are in compliance with the reserve requirement. The total amount reserved as of December 31, 2008 and 2007, was \$9,663,522 and \$9,039,862, respectively.

Pennsylvania Department of Insurance Reserve Requirements

On a calendar-year basis, BV is required by the Continuing Care Provider Registrations and Disclosure Act of 1984 to maintain a working-capital reserve equivalent to the greater of the total of debt service payments due during the next 12 months on account of any loans or 10% of the projected annual operating expenses, exclusive of depreciation, computed only on the proportional share of financing or operating expenses that are applicable to residents of BV under continuing-care agreements. The projected annual debt service requirements for BV for the years ended December 31, 2008 and 2007, exceeded 10% of BV's projected operating expense (as defined) for those respective years.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

3. Regulatory Environment (continued)

Pennsylvania Department of Insurance Reserve Requirements (continued)

BV's minimum liquid reserve was as follows:

	December 31	
	2008	2007
Projected annual debt service payments	\$ 7,216,384	\$ 4,209,424
Approximate percentage of continuing-care clients	68%	67%
Minimum liquid reserve requirement	\$ 4,907,141	\$ 2,830,129

SH must adhere to the same reserve requirements. At SH, projected annual debt service requirements exceed 10% of its projected annual operating expenses. SH's minimum liquid reserve was as follows:

	December 31	
	2008	2007
Projected annual debt service payments	\$ 1,404,172	\$ 1,376,023
Approximate percentage of continuing-care clients	56%	57%
Minimum liquid reserve requirement	\$ 786,336	\$ 786,723

EM must adhere to the same reserve requirements. At EM, projected annual debt service requirements did not exceed 10% of its projected annual operating expenses. EM's minimum liquid reserve was as follows:

	December 31	
	2008	2007
10% of projected annual operating expenses	\$ 866,442	\$ 822,460
Approximate percentage of continuing-care clients	7%	7%
Minimum liquid reserve requirement	\$ 60,651	\$ 54,878

Pennsylvania statute also requires that all 10% deposits made by future residents of units under construction be held in escrow. Subsequent to receipt of the use and occupancy permits, the escrow funds will be transferred directly from the escrow fund to a bond trustee held fund. These funds are held in cash and cash equivalents.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

4. Net Resident-Service Revenue

Net resident-service revenue is reported at the estimated net realizable amounts from residents, third-party payors and others for services rendered.

A summary of gross and net resident-service revenue is as follows:

	Year Ended December 31	
	2008	2007
Gross resident-service revenue	\$ 131,887,376	\$ 123,885,148
Less provisions for:		
Contractual allowance under third-party reimbursement programs	(8,182,704)	(7,195,147)
Benevolent and charity care	(1,706,848)	(2,039,456)
Net resident-service revenue	<u>\$ 121,997,824</u>	<u>\$ 114,650,545</u>

Approximately 16% and 20% of net resident-service revenue for the years ended December 31, 2008 and 2007, respectively, were derived under federal and state reimbursement programs.

5. Concentration of Credit Risk

The Company grants credit without collateral to its residents, some of whom are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	December 31	
	2008	2007
Private pay	38%	27%
Medicaid	25	32
Medicare	24	35
Other (primarily managed care and insurance)	13	6
	<u>100%</u>	<u>100%</u>

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

6. Investments

The investment portfolios, including assets whose use is limited and investments restricted by Board at fair value, consisted of the following:

	December 31	
	2008	2007
Investments:		
Fixed-income mutual funds	\$ 11,927,350	\$ 6,371,496
Equity mutual funds	15,571,715	9,458,632
Equity interests funds	6,370,604	36,510,969
Real estate mutual funds	1,351,823	920,176
Investment in land	134,192	134,192
Total investments	\$ 35,355,684	\$53,395,465
Investments restricted by donors:		
Cash and short-term investments	\$ 39,066	\$ 32,972
U.S. Treasury obligations	-	43,552
Fixed-income mutual funds	7,009,086	3,471,544
Equity securities and equity mutual funds	5,911,615	3,606,305
Equity interests funds	3,025,778	16,104,201
Real estate mutual funds	711,986	303,234
Total investments restricted by donors	\$ 16,697,531	\$ 23,561,808
Statutory reserves:		
Cash and short-term investments	\$ 13,036,829	\$ 4,203,064
Equity interests funds	2,380,821	8,519,300
Total statutory reserves	\$ 15,417,650	\$ 12,722,364
Investments held under bond indenture:		
Cash and short-term investments	\$ 15,469,382	\$ 13,132,240
Fixed-income corporate securities	3	3
Total investments held under bond indenture	\$ 15,469,385	\$ 13,132,243

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

6. Investments (continued)

	December 31	
	2008	2007
Investments restricted by Board:		
Fixed-income mutual funds	\$ 1,208,561	\$ 551,223
Equity mutual funds	1,457,215	693,083
Equity interests funds	624,606	2,846,933
Real estate mutual funds	148,399	60,537
Total investments restricted by Board	\$ 3,438,781	\$ 4,151,776

At December 31, 2008 and 2007, the equity interests funds were comprised of the following holdings:

	2008	2007
Large cap	–%	30%
Small cap	–	6
International	–	13
Real estate	19	6
Bond fund	–	16
Non-directional hedge funds	47	24
Private equity funds	34	5
Total	100%	100%

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

6. Investments (continued)

Assets limited as to use held by trustee under bond indenture are maintained for the following purposes as of December 31:

	2008	2007
Deposits held in trust	\$ 43,771	\$ 32,592
Debt-service fund	6,013,943	4,658,274
Debt-service reserve fund	8,056,157	8,284,951
Cost of issuance fund	14,251	104,330
Project fund series A	1,204,335	–
Capitalized interest	67,245	–
Entrance-fee fund	14,254	3,378
Bond credit facility fund	499	487
Operating-reserve fund	4,722	4,671
Settlement fund	6,497	–
Letter of credit fund	43,711	43,560
Total	15,469,385	13,132,243
Less current portion	(5,835,634)	(4,469,922)
Long-term portion of bond indenture	\$ 9,633,751	\$ 8,662,321

The total return on investments, along with investments classified as assets whose use is limited and investments restricted by Board, including the change in the market value of derivative instruments, generated net investment income excluding capitalized interest income as follows:

	Year Ended December 31	
	2008	2007
Included within the Company's performance indicator:		
Interest and dividend income, net	\$ 1,764,976	\$ 3,883,345
Net realized (losses) gain on investments	(62,400)	192,011
Proportionate share of (losses) earnings in equity interests	(7,525,487)	2,812,104
Net unrealized losses on change in market value of derivative instruments	(17,231,328)	(5,066,875)
Other-than-temporary loss on investments	(19,143,608)	(433,645)
	(42,197,847)	1,386,940
Included in other changes in net deficit:		
Other unrealized (loss) gain on investments	(957,108)	328,205
Total	\$ (43,154,955)	\$ 1,715,145

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

6. Investments (continued)

Interest and dividend income is presented net of capitalized interest income related to construction projects.

Other-than-temporary losses on investments represent losses incurred from investments whose market value is below the cost of the investments. The Company engages professionals to manage its investment portfolio within guidelines of the Company's Board-approved investment policy. As the Company does not place restrictions on the buying and selling of securities (other than those stated in the investment policy), as of December 31, 2008 and 2007, all investments holdings with fair value less than cost were considered other-than-temporarily impaired. The Company does not have the ability to hold these investments for a period of time sufficient to allow for a recovery in market value since the underlying investments within the investment fund are managed by the Company's investment managers.

On February 26, 2009, ACOMM sold \$31.4 million of its equity and real estate mutual funds investments and placed the proceeds from the sale into cash and cash equivalent accounts.

7. Property and Equipment

The following is a summary of property and equipment:

		December 31	
	Useful Life	2008	2007
Land and improvements	10 – 40 years	\$ 37,390,323	\$ 33,214,008
Buildings and improvements	10 – 40 years	465,930,244	449,472,963
Furniture and equipment	2 – 15 years	58,265,690	55,409,323
Construction in progress		5,898,589	9,452,039
		567,484,846	547,548,333
Less accumulated depreciation		(182,121,650)	(163,247,122)
Property and equipment, net		\$ 385,363,196	\$ 384,301,211

Depreciation expense was \$18,879,353 and \$18,237,017 for the years ended December 31, 2008 and 2007, respectively.

Interest is capitalized for assets that require a period of time to be constructed or to prepare them for their intended use. For the years ended December 31, 2008 and 2007, the amount of interest expense capitalized was \$312,481 and \$153,981, respectively.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

8. Pledges Receivable

Pledges receivable were recorded at their net present value using an estimated discounted rate and consisted of the following:

	December 31	
	2008	2007
Amounts expected to be collected in:		
Less than one year	\$ 150,705	\$ 200,062
One year to five years	–	26,921
More than five years	–	–
	\$ 150,705	\$ 226,983

Pledges receivable were recorded net of reserve for uncollectible pledges of \$76,541 and \$69,378 as of December 31, 2008 and 2007, respectively.

9. Obligations Under Deferred-Giving Arrangements

AFOUND and BV are the beneficiaries of various deferred-giving arrangements created by donors, the assets for which AFOUND and BV are not the trustees. AFOUND and BV have legally enforceable rights on claims to such assets after the donor's or current beneficiary's death. The present value of these funds held in trust by others, based on the donor's or current beneficiary's life expectancy, is recorded as a permanently restricted net asset.

Obligations related to deferred-giving arrangements issued by AFOUND and BV are recorded at the present value of the future interest payments based on the donor's life expectancy. Amounts donated in excess of the liability are recorded as temporarily restricted or permanently restricted donations in the consolidated statements of operations and changes in net deficit. The present value of the liability is determined by discounting estimated future payments at the adjusted federal rate. This rate is adjusted annually and was 2.71% and 3.71% at December 31, 2008 and 2007, respectively. Changes in the present value of the liability are shown as changes in values of deferred-giving arrangements in the consolidated statements of operations and changes in net deficit.

AFOUND is required by Maryland state law to maintain segregated assets for all annuities issued in an amount at least equal to the sum of its outstanding deferred-giving arrangements liability discounted to present value. At December 31, 2008 and 2007, AFOUND had segregated \$4,703,040 and \$6,560,231 as investments restricted by donors in the accompanying

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

9. Obligations Under Deferred-Giving Arrangements (continued)

consolidated balance sheets as of December 31, 2008 and 2007, respectively, and therefore has met its minimum reserve requirement at December 31, 2008 and 2007. BV is not subject to any requirements under the commonwealth of Pennsylvania.

10. Debt

Long-term debt consisted of the following:

	Interest Rate	Maturity Dates	December 31	
			2008	2007
Series 2006 PA Bonds	Variable (1.10% as of December 31, 2008)	2009 – 2041	\$ 111,660,001	\$ 112,215,000
Series 2006 A MD Bonds	5.125%	2023 – 2036	82,780,000	82,780,000
Series 2006 B MD Bonds	Variable (1.20% as of December 31, 2008)	2018 – 2023	17,880,000	17,880,000
Series 2006 C MD Bonds	Variable (2.25% as of December 31, 2008)	2009 – 2018	28,200,000	29,905,000
Series 2007 IV Bonds	Variable (1.15% as of December 31, 2008)	2009 – 2042	71,000,000	71,000,000
Series 2008 PA Bonds	Variable (1.20% as of December 31, 2008)	2010 – 2043	13,060,000	–
			324,580,001	313,780,000
Unamortized bond premium			2,282,735	2,367,272
Current portion			(6,005,001)	(2,260,000)
Long-term debt			\$ 320,857,735	\$ 313,887,272

Series 2008 PA Bonds

On April 17, 2008, the Cumberland County Municipal Authority issued its Variable Rate Demand Revenue Bonds (Asbury Atlantic Pennsylvania Obligated Group) Series 2008 in the aggregate principal amount of \$16,750,000 (the Series 2008 Pennsylvania Bonds) pursuant to Master Loan Agreements between Asbury Atlantic, Inc. as the sole member of the Pennsylvania Obligated Group and the Municipal Authority (Master Loan Agreements). Asbury Atlantic will use the proceeds from the Series 2008 Pennsylvania Bonds to finance the construction of 47 independent living cottage units, including 42 duplex cottage units and five single cottage units, on approximately 20 acres of the BV community. Asbury Atlantic has pledged the assets and net revenues of its non-Maryland assets to pay the principal of, and premium, if any, and interest on all bonds issued under the Master Loan Agreements.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

10. Debt (continued)

Series 2008 PA Bonds (continued)

Under the Pennsylvania Master Loan Agreements, the lenders have a first lien and claim on all receipts of the Pennsylvania Obligated Group, except the restricted donations and contributions. The terms of the indenture agreements restrict the Company's ability to create additional indebtedness; restrict its use of the BV, SH and EM facilities; and require the Pennsylvania Obligated Group to maintain stipulated insurance coverage. Additionally, the Pennsylvania Obligated Group covenants that it will fix, charge and collect in each fiscal year amounts sufficient to meet a defined annual debt-service coverage ratio for the obligated group, meet a combined annual net operating margin ratio and will maintain a minimum days of cash-on-hand ratio. In addition, ACOMM has agreed to contribute cash to the Pennsylvania Obligated Group under certain circumstances and has agreed to maintain a minimum days of cash-on-hand ratio.

The Series 2008 Pennsylvania Bonds mature at various dates beginning January 1, 2010 and ending January 1, 2043, and bear interest at rates not to exceed a maximum rate of 12%. Pursuant to the loan agreement, the Series 2008 Pennsylvania Bonds have the option to convert to a fixed rate of interest. Additionally, at the expiration of the fixed-rate period, these Series 2008 of bonds have the option to convert back to a variable-interest rate or to establish one or more fixed-rate periods. Interest payments are due monthly. Payment of the principal and interest on the Series 2008 Pennsylvania Bonds is backed by a letter of credit from KBC Bank. The letter of credit will expire October 15, 2011.

Series 2007 IV Bonds

On November 29, 2007, the Company current and advanced refunded all of the then outstanding \$61,690,000 of the Series 2002 Bonds (\$63,789,433 outstanding as of December 31, 2008) with the proceeds from the issuance of the \$71,000,000 Oklahoma Development Finance Authority Continuing Care Retirement Community Variable Rate Revenue Refunding Bonds (Inverness Village Project) Series 2007A (the Series 2007 Bonds). The Series 2007 Bonds were issued pursuant to a master loan agreement between the Company and the Oklahoma Development Finance Authority (Loan Agreement). The Company has pledged the assets and net revenues of the Company to pay the principal of and premium, if any, and interest on all bonds issued under the Loan Agreement.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

10. Debt (continued)

Series 2007 IV Bonds (continued)

These bonds will remain outstanding, but are defeased from the accounting records until their first call date, which is February 15, 2009, for the Inverness bonds. The Company has determined that for bonds that were defeased in 2007, the requirements made under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities: a replacement of FASB Statement 125*, continue to be met as of December 31, 2008. In this regard, the Company has determined that the Company has been relieved of its repayment obligations related to the defeased bonds and that the transferred financial assets have been isolated, put presumptively beyond the reach of the Company, its creditors, or other receiver for the Company. During 2007, the Company recorded a loss of \$18,162,265, including \$6,389,983 related to the write-off of deferred financing costs.

The Series 2007 Bonds mature at various dates beginning January 1, 2009 and ending January 1, 2042, and bear interest at rates not to exceed a maximum rate of 10%. Pursuant to the Loan Agreement, the Series 2007 bonds have the option to convert to a fixed rate of interest. Additionally, at the expiration of the fixed-rate period, these series of bonds have the option to convert back to a variable-interest rate or to establish one or more fixed-rate periods. Interest payments commenced on January 1, 2008, and are due monthly. Payment of the principal and interest on the Series 2007 bonds is backed by a letter of credit from KBC Bank. The letter of credit will expire November 15, 2012.

Under the Loan Agreement, the lenders have a first lien and claim on all receipts of the Company, except the restricted donations and contributions. The terms of the indenture agreements restrict the Company's ability to create additional indebtedness, restrict its use of facilities and require the Company to maintain stipulated insurance coverage. Additionally, the Company covenants that it will fix, charge and collect in each fiscal year amounts sufficient to meet a defined debt-service coverage ratio, meet an operating margin ratio and will maintain a minimum days of cash-on-hand ratio. In addition, the Company covenants it will maintain defined occupancy requirements.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

10. Debt (continued)

Series 2007 IV Bonds (continued)

ACOMM Subordinate Loan

On November 29, 2007, in connection with the 2007 refinancing, ACOMM entered into a subordinate loan agreement with IV (ACOMM Subordinate Loan) in the amount of \$11,500,000. The proceeds from the ACOMM Subordinate Loan were used to refund the \$4,000,000 subordinate loan with the Bank of Scotland and fund working capital for IV. The ACOMM Subordinate Loan shall accrue interest at a rate of 5% per annum and no payment of principal or interest be made by IV on the ACOMM Subordinate Loan until the Series 2007 IV bonds are fully repaid or the letter of credit allows such payments to ACOMM.

Series 2006 Maryland (MD) Bonds

Under the Maryland Master Loan Agreements, the lenders have a first lien and claim on all receipts of the Maryland Obligated Group, except the restricted donations and contributions. The terms of the indenture agreements restrict the Company's ability to create additional indebtedness, restrict its use of AMV and A~S facilities, and require the Maryland Obligated Group to maintain stipulated insurance coverage. Additionally, the Maryland Obligated Group covenants that it will fix, charge and collect in each fiscal year amounts sufficient to meet a defined debt-service coverage ratio for the obligated group, meet a combined annual net operating margin ratio and will maintain a minimum days of cash-on-hand ratio. In addition, ACOMM has agreed to contribute cash to the Maryland Obligated Group under certain circumstances and has agreed to maintain a minimum days of cash-on-hand ratio. The Maryland Obligated Group was in technical default of a bond covenant for each of the three quarters ended September 30, 2007. The Maryland Obligated Group requested, and the financial institution approved, a waiver of the covenant violation for each default through September 30, 2007. The Maryland Obligated Group was in compliance as of December 31, 2007. The Maryland Obligated Group was in compliance for each of the four quarters ended December 31, 2008.

For financial statement purposes, AMV and A~S have allocated the liability for payment of principal and interest on the bonds in an amount equal to the proportion of the bonds used to refund debt at each respective facility.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

10. Debt (continued)

Series 2006 Pennsylvania (PA) Bonds

Under the Pennsylvania Master Loan Agreements, the lenders have a first lien and claim on all receipts of the Pennsylvania Obligated Group, except the restricted donations and contributions. The terms of the indenture agreements restrict the Company's ability to create additional indebtedness; restrict its use of SH, BV and EM facilities; and require the Pennsylvania Obligated Group to maintain stipulated insurance coverage. Additionally, the Pennsylvania Obligated Group covenants that it will fix, charge and collect in each fiscal year amounts sufficient to meet a defined annual debt-service coverage ratio for the obligated group, meet a combined annual net operating margin ratio and will maintain a minimum days of cash-on-hand ratio. In addition, ACOMM has agreed to contribute cash to the Pennsylvania Obligated Group under certain circumstances and has agreed to maintain a minimum days of cash-on-hand ratio. The Pennsylvania Obligated Group was in technical default of a bond covenant for each of the three quarters ended September 30, 2007. The Pennsylvania Obligated Group requested, and the financial institution approved, a waiver of the covenant violation for each default through September 30, 2007. The Pennsylvania Obligated Group was in compliance as of December 31, 2007. The Pennsylvania Obligated Group was in compliance for each of the four quarters ended December 31, 2008.

For financial statement purposes, SH, BV and EM have allocated the liability for payment on the bonds in an amount equal to the proportion of the bonds used to refund debt at each respective facility.

Reeders Bonds Payable

The Washington County Healthcare Facilities Revenue Bonds Series 1994 (Series 1994 Reeders Bonds) were due February 2018, and were collateralized by all property and receipts of Reeders.

The Town of Boonsboro, Maryland, Economic Development Revenue Bond Series 1999 (Series 1999 Reeders Bonds) were due August 2019, and were collateralized by all property and receipts of Reeders.

As security for the debt-service requirements of the Series 1994 Bonds and Series 1999 Bonds, Reeders pledged all of their future receipts except restricted donations and contributions as collateral.

The Reeders Bonds were fully repaid from the proceeds of the sale of Reeders on January 1, 2007 (see Note 19).

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

10. Debt (continued)

Refinanced WAS Bonds Payable

The Series 2002 A Bonds, issued in the amount of \$62,245,000, bore interest at fixed rates varying from 6.00% to 7.25%; \$26,555,000 and \$35,690,000 were advanced refunded and defeased in December 2005 and November 2006, respectively. These bonds will remain outstanding until their first call date, which is January 1, 2013. As of December 31, 2008, there was \$28,025,002 in the defeasance escrow account.

Asbury Atlantic has determined that for transactions defeased both in 2008 and 2007, the requirements under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities: a replacement of FASB Statement 125*, continue to be met as of December 31, 2008. We have determined that Asbury Atlantic has been relieved of its repayment obligations related to the defeased bonds and that the transferred financial assets have been isolated – put presumptively beyond the reach of Asbury Atlantic, its creditors, or other receiver for Asbury Atlantic.

Refinanced Series 2002 IV Bonds Payable

The Series 2002 A and B Bonds were advance refunded with a portion of the proceeds from the new Series 2007 Bonds. These funds were placed in an escrow account with a trustee in order to pay the principal and interest until the Series 2002 A and B Bonds' first call dates, which are February 1, 2012 and February 15, 2009, respectively. The Series 2002 C Bonds were refunded on December 10, 2007, with a portion of the Series 2007 Bond proceeds that were placed with a trustee on November 29, 2007. A portion of the Series 2007 Bond proceeds was also used to pay a portion of the costs of issuance of these bonds.

Refinanced Series 1997 A~S Bonds Payable

The Series 1997 Bonds were advance refunded in 2006. These bonds will remain outstanding, but are defeased from the accounting records until their first call date, which was January 1, 2008. As of December 31, 2008, there was \$2,057,685 in the escrow balance.

Bonds Backed By Letter of Credit

For those bonds backed by letter of credit and subject to remarketing agreements, in the event that any or all of the Bonds are tendered by the bondholder and are unable to be remarketed, the letter of credit would be drawn upon to repay the tendered bonds. Any drawings under the letter of credit are repayable on or before the first to occur of the following: the date on which the

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

10. Debt (continued)

Bonds Backed By Letter of Credit (continued)

Bonds purchased with the proceeds from a draw on the letter of credit are successfully remarketed by the remarketing agent, the date on which the Bonds purchased with the proceeds from a draw on the letter of credit are redeemed or otherwise paid in full, or the date the letter of credit expires. The letter of credit for both the Series 2006 MD Bonds and Series 2006 PA Bonds will expire October 15, 2011.

Debt Maturities

A schedule of minimum maturities of debt for the next five years and thereafter is as follows:

2009	\$ 6,005,001
2010	4,035,000
2011	4,230,000
2012	4,435,000
2013	4,975,000
Thereafter	<u>300,900,000</u>
	<u>\$ 324,580,001</u>

11. Derivative Instruments

The Company's affiliates entered into various swap and forward-rate purchase agreements with certain investment companies, which reduce their exposure to volatility of interest rates on debt. Under these agreements, beginning on the effective date, the Company's affiliates pay a fixed rate of interest, as noted in the table below, while the investment company pays the affiliate based on a floating rate as derived from a tax-exempt bond rate index or a percentage of London Interbank Offered Rate. The floating rate resets every seven days. The difference between the fixed and floating rates is accrued and recorded in interest expense in the accompanying consolidated statements of operations and changes in net deficit. The notional amounts decline over time to hedge the interest rate exposure for the Company. These agreements are with investment companies that have investment grade credit ratings from Standard & Poor's and Moody's. These agreements have provisions that if the investment company falls below certain investment grade ratings, the investment company is required to either obtain a replacement investment company or post collateral equal to or more than the value of the derivative instrument.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

11. Derivative Instruments (continued)

Asbury Atlantic entered into a Forward Contract concurrent with the issuance of the Series 2006 bonds, and A~S entered into an interest rate basis swap in August 2001. Lehman Brothers Special Financing, Inc. (Lehman SFI) is the investment company or counterparty in both of these derivative agreements. Lehman SFI entered into bankruptcy in early October 2008 following its ultimate parent entering bankruptcy in mid-September 2008. Interest rate swap payments are not due under the Forward Contract and the semiannual interest rate basis swap payments were not made from A~S to Lehman SFI for the A~S interest rate swap in January 2009. All differences between the fixed and floating rates on the A~S interest rate basis swap were accrued and recorded in interest expense in 2008 and 2007.

Unless cured within a proper notice period, an event of default under the swap agreement will have been deemed to have occurred and Asbury Atlantic and/or A~S, as applicable, may deliver notice (at their option) to terminate either or both of the agreements. However, there have not been any notices delivered by Asbury Atlantic, A~S, or Lehman SFI or a bankruptcy administrator for Lehman SFI, which notices any such default or which would result in termination of the swap agreement.

The lenders, as third-party beneficiaries to the hedging agreement, are fully aware that Lehman SFI is the counterparty. Based upon the uncertain future of the existing hedging agreement with Lehman SFI, the Company has engaged legal counsel to assist the Company while Lehman SFI is in bankruptcy. There are no assurances that replacement instruments would be available to Asbury Atlantic or A~S on acceptable terms, if at all. Management believes that the inability to obtain a replacement hedging instrument would not have a negative impact on the Company.

IV entered into an interest rate swap agreement concurrent with the issuance of the Series 2007 Bonds to mitigate exposure to fluctuating variable interest rates. Under this agreement, the Company pays a 3.1275% fixed rate of interest and receives payments based on a floating rate derived from the Securities Industry and Financial Markets Association Municipal Swap Index (formerly known as the BMA Municipal Swap Index). The interest rate swap agreement terminates on February 1, 2012.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

11. Derivative Instruments (continued)

The following schedule outlines the terms and fair market values of the derivative instruments on December 31, 2008 and 2007:

	Series 2006		PA Series 2006		IV Series 2007	
	Asbury Atlantic (MD) Forward Contract	A~S Interest Rate Swap	Interest Rate Swap	Interest Rate Swap	Interest Rate Swap	Total
Notional amount	\$ 73,936,000	\$ 36,400,000	\$ 112,215,000	\$ 71,000,000		
Trade date	12/8/2006	8/13/2001	10/20/2006	11/27/2007		
Effective date	1/1/2013	8/23/2001	10/27/2006	11/29/2007		
Termination or cancellation date	1/1/2041	1/1/2027	1/2/2013	2/1/2012		
Fixed rate	5.128%	5.540%	3.485%	3.128%		
Fair value at December 31, 2006	(8,910,071)	(56,082)	(749,902)	-	-	\$ (9,716,055)
Unrealized loss	(1,163,959)	(182,923)	(3,094,367)	(625,626)	-	(5,066,875)
Fair value at December 31, 2007	(10,074,030)	(239,005)	(3,844,269)	(625,626)	-	(14,782,930)
Unrealized loss	(8,114,533)	(1,417,220)	(5,226,131)	(2,473,444)	-	(17,231,328)
Fair value at December 31, 2008	\$ (18,188,563)	\$ (1,656,225)	\$ (9,070,400)	\$ (3,099,070)	-	\$(32,014,258)

The Company has included the fair market value of these derivative instruments as a liability of \$32,014,258 and \$14,782,930 in the accompanying consolidated balance sheets as of December 31, 2008 and 2007, respectively.

Net unrealized loss on derivative instruments was \$17,231,328 and \$5,066,875 in 2008 and 2007, respectively, that were recognized within the loss from operations.

12. Temporarily Restricted Net Assets

Temporarily restricted net assets were available for the following purposes:

	December 31	
	2008	2007
Benevolent and charity care	\$ 439,057	\$ 393,052
Buildings, equipment and supplies	1,700,767	1,472,803
Total temporarily restricted net assets	\$ 2,139,824	\$ 1,865,855

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

13. Permanently Restricted Net Assets

Permanently restricted net assets, totaling \$21,954,643 and \$21,994,377, as of December 31, 2008 and 2007, respectively, consist of investments to be held in perpetuity. Investment income earned from the permanently restricted net assets is available for operations of the supported organizations including funding of benevolent and charity care.

14. Retirement Plan

ACOMM has a defined-contribution plan (the Plan) under IRC Section 401(k). All full-time employees of the Company are eligible to participate in the Plan. Employees may elect to defer up to \$15,500 of their base salary, subject to certain limitations. The employer's basic contribution is 3% of compensation for each eligible employee. ACOMM will also match the employee's contribution up to 2% of the employee's base salary. The employer's contribution expense for the years ended December 31, 2008 and 2007, was \$2,133,081 and \$2,023,166, respectively.

15. Commitments and Contingencies

General and Professional Liability Insurance

The Company and its affiliates have professional and general liability insurance policies, which are claims-made based. Both policies have a limit of \$1,000,000 per occurrence and a \$3,000,000 aggregate. The Company and affiliates also have an umbrella policy in effect with an annual limit of \$15,000,000 per claim and in the aggregate. These policies have been renewed through December 31, 2009. Liability for professional and general losses not currently covered by insurance in force is not expected to be material to the financial statements.

Health Insurance

The Company and its affiliates have a self-funding arrangement for health insurance coverage. ACOMM and affiliates have stop-loss coverage up to \$125,000 per participant and an annual aggregate of approximately 125% of expected claims with a maximum reimbursement of \$2,000,000 per year. The annual aggregate fluctuates based on the number of participants and is calculated based on historical claims information. The insurance policies have been renewed through July 31, 2009.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

15. Commitments and Contingencies (continued)

Legal Actions and Claims

The Company is party to various legal actions and claims arising in the ordinary course of its business. The Company's management believes that their ultimate disposition will not have material adverse effect on the Company's consolidated financial position or results of operations.

Lease Commitments

The Company and its affiliates have leases for vehicles and office equipment, which expire in 2013, and a ground lease that expires on August 1, 2039. Generally, the leases carry renewal provisions and require the Company and its affiliates to pay maintenance costs. Total lease expense for the years ended December 31, 2008 and 2007, was \$1,663,045 and \$1,673,920, respectively.

The future rental commitments for noncancelable operating leases are as follows:

2009	\$ 1,098,176
2010	1,037,003
2011	996,514
2012	887,659
2013	798,433
Thereafter	<u>2,382,574</u>
	<u>\$ 7,200,359</u>

In December 2006, ACOMM entered into a 10-year and three months noncancelable office lease agreement for approximately 19,600 square feet of office in Germantown, Maryland, to be used as the Company's corporate office. In accordance with the lease agreement, the term of the lease began in May 2007 once the landlord completed certain improvements to the office space. ACOMM will pay annual base rent payments ranging from \$400,898 to \$527,004. These commitments are included in the future rental commitments payments above.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

15. Commitments and Contingencies (continued)

Capital Lease

The Company and its affiliates lease computer equipment under a capital lease agreements expiring in 2011. As of December 31, 2008, the future minimum lease payments under capital leases were as follows:

2009	\$ 282,057
2010	133,640
2011	19,683
Total future minimum lease payments	435,380
Less amount representing interest	(22,440)
Present value of lease obligation	412,940
Current portion	(263,419)
Long-term portion	\$ 149,521

16. Functional Expenses

The Company provides continuing and long-term care for the elderly. Expenses related to providing these services were as follows:

	Year Ended December 31	
	2008	2007
Continuing and long-term care	\$ 115,812,299	\$ 109,793,351
General and administrative	48,902,151	51,541,762
Total functional expenses	\$ 164,714,450	\$ 161,335,113

17. Fair Value of Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, prepaid expenses and other assets, pledges receivable net, accounts payable and accrued expenses, short-term borrowings from bank, construction retainage payable and accrued interest payable approximate fair value given the short-term nature of the financial instruments. The following methods and assumptions were used by the Company in estimating the fair value of other financial instruments:

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

17. Fair Value of Financial Instruments (continued)

Investments, Assets Whose Use Is Limited and Board-Designated Funds

Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Bonds Payable

The variable rate bonds are assumed to be carried at fair value. The fair value of fixed rate bonds are estimated based upon discounted cash flows using a discount rate commensurate with the company's borrowing rate as of the balance sheet date. The estimated fair value of the bonds payable was \$294,863,027 and \$307,229,999 as of December 31, 2008 and 2007, respectively.

Lines of Credit and Notes Payable

The carrying amounts of the lines of credit and notes payable at December 31, 2008, approximates fair value because they were based on rates similar to those then offered to ACOMM for debt of the same remaining maturities.

Adoption of SFAS 157

Effective January 1, 2008, the Company adopted SFAS 157 as discussed in Note 2, which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value.

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements and endeavors to utilize the best available information. Accordingly, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

17. Fair Value of Financial Instruments (continued)

Adoption of SFAS 157 (continued)

The Company's assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. Also, the time between inception and performance of the contract may affect the fair value. The determination of fair value may, therefore, affect the timing of recognition of revenues and net income.

SFAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by SFAS 157 are as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date.

Level 2 – Pricing inputs are other-than-quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

The following table sets forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

17. Fair Value of Financial Instruments (continued)

Adoption of SFAS 157 (continued)

Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Recurring Fair Value Measures	At Fair Value as of December 31, 2008			
	Level 1	Level 2	Level 3	Total
Assets				
Equity securities and mutual funds	\$ 22,940,545	\$ –	\$ –	\$ 22,940,545
Fixed-income mutual funds	20,144,997	–	–	20,144,997
Other	2,212,208	–	150,705	2,362,913
Total	\$ 45,297,750	\$ –	\$ 150,705	\$ 45,448,455
Liabilities				
Derivative instruments	\$ –	\$(32,014,258)	\$ –	\$(32,014,258)
Total	\$ –	\$(32,014,258)	\$ –	\$(32,014,258)

The determination of the fair values above incorporates various factors required under SFAS 157. These factors include not only the credit standing of the counterparties involved and the impact of credit enhancements (such as cash deposits, letters of credit and priority interests), but also the impact of the Company's nonperformance risk on its liabilities.

The fair value of investments is determined by third-party service providers utilizing various methods dependent upon the specific type of investment. When quoted prices are available in the active market, securities are classified within Level 1 of the valuation hierarchy. Assets utilizing Level 1 inputs include equity securities and mutual funds, fixed-income mutual funds and real estate mutual funds.

Liabilities utilizing Level 2 inputs are derivatives. A quoted price can be obtained from a number of dealer counterparties and other independent market sources based on observable interest rates and yield curves for the full term of the asset or liability, thus derivative instruments are classified within Level 2 of the valuation hierarchy.

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

18. Income Taxes

Income taxes for PivH and TAG (collectively the taxable subsidiaries) are recorded under SFAS No. 109, *Accounting for Income Taxes*. Because of the immateriality of income tax expense for these subsidiaries to the consolidated financial statements taken as a whole, the tax expense is included in the income statement as general and administrative expense.

Taxable loss before income taxes was \$942,041 and \$169,414 for the years ended December 31, 2008 and 2007, respectively.

The components of the taxable subsidiaries' (benefit) provision for income taxes for the years ended December 31, 2008 and 2007, consist of the following:

	December 31	
	2008	2007
Current:		
Federal	\$ (184,603)	\$ 110,188
State	(46,456)	24,096
Total current	(231,059)	134,284
Deferred	-	-
	<u>\$ (231,059)</u>	<u>\$ 134,284</u>

Asbury Communities, Inc.

Notes to Consolidated Financial Statements (continued)

18. Income Taxes (continued)

The components of deferred tax assets and liabilities at December 31, 2008 and 2007, are as follows:

	December 31	
	2008	2007
Net operating loss carryforwards	\$ 173,119	\$ 126,218
Accrued paid time-off benefits	155,845	195,122
Accrued long-term compensation	124,735	–
Accrued salaries	6,616	58,157
Accrued health insurance	18,251	19,033
Rent	28,987	21,616
Deferred revenue	29,431	30,840
Prepaid insurance	(8,339)	(6,676)
Other prepaids	–	13,568
Depreciation	112,809	(100,917)
Amortization	50,379	–
Federal AMT	11,790	–
Valuation allowance	(703,623)	(356,961)
Deferred tax asset	\$ –	\$ –

Management has determined, based on the taxable subsidiaries' lack of history of operating earnings, that it is more likely than not taxable income will not be sufficient to fully realize the net deferred tax asset; therefore, a valuation reserve has been established for the full amount. Net operating loss carryforwards for PivH are \$323,637, which expire at various dates through 2020. The effective income tax rate of the taxable subsidiaries of 25% differs from the statutory federal tax rate of 34% for the year ended December 31, 2008, primarily due to state and local taxes and the change in valuation allowance.

19. Sale of Assets Relating to Discontinued Operations

On January 1, 2007, ACOMM sold substantially all of the assets of Reeder's to an unrelated outside party for a total sales price of \$6,000,000. In connection with the sale, ACOMM recognized a gain of \$398,416.

Other Financial Information

Report of Independent Auditors

Audit Committee
Asbury Communities, Inc.

Our audit was conducted for the purpose of forming an opinion on the December 31, 2008, consolidated financial statements taken as a whole. The consolidating information enclosed is presented for purposes of additional analysis and is not a required part of the December 31, 2008, consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audit of the December 31, 2008, consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the December 31, 2008, consolidated financial statements taken as a whole.

Ernst & Young LLP

April 28, 2009

Asbury Communities, Inc.
Consolidating Balance Sheet

December 31, 2008

	Asbury Communities, Inc.	Asbury Methodist Village	Asbury Solomons, Inc.	Epworth Manor	Bethany Village	Springhill	Inverness Village, Inc.	Asbury Foundation, Inc.	Wesley Affiliated Services Foundation, Inc.	The Asbury Group, Inc.	Eliminations	Consolidated Balance
Assets												
Current assets:												
Cash and cash equivalents	\$ 55,607	\$ 93,111	\$ 133,940	\$ 331,086	\$ 141,615	\$ 1,748,535	\$ 8,662,780	\$ -	\$ -	\$ 102,064	\$ -	\$ 11,268,738
Investments	17,886,097	13,490,407	-	621,267	3,066,622	7,704	2,366	146,615	414	-	-	35,221,492
Accounts receivable, net	-	3,370,108	429,822	768,232	644,396	833,326	472,730	-	-	147,715	-	6,666,329
Pledges receivable, net	-	-	-	-	-	-	-	116,055	34,650	-	-	150,705
Other receivables and prepaid expenses	33,680	4,113,127	620,277	174,342	1,036,389	436,879	1,124,628	8,341	-	728,921	-	8,276,584
Investments held under bond indenture	-	1,789,660	2,601,578	80,456	1,160,516	159,653	43,771	-	-	-	-	5,835,634
Total current assets	17,975,384	22,856,413	3,785,617	1,975,383	6,049,538	3,186,097	10,306,275	271,011	35,064	978,700	-	67,419,482
Due from ACOMM, net	25,811,396	7,387,866	-	136,369	-	-	-	5,360,651	1,471,856	-	(40,168,138)	-
Property and equipment, net	540,945	137,568,556	52,814,913	10,275,007	97,492,260	21,062,029	67,488,280	13,305	-	1,243,760	(3,135,859)	385,363,196
Investments restricted by donors	-	-	-	351,854	6,720,092	-	-	9,625,585	-	-	-	16,697,531
Long-term investments	1,291,616	-	-	-	134,192	-	-	-	-	-	(1,291,616)	134,192
Deferred costs, net	-	2,673,215	2,675,812	199,003	2,648,241	544,227	6,483,915	-	-	-	-	15,224,413
Deposits and other assets	26,135	105,052	-	183,875	119,076	2,618	-	-	-	18,763	-	455,519
Other intangible assets	-	-	-	-	-	2,845,352	-	-	-	162,663	-	3,008,015
Investments held under bond indenture	-	6,881,342	1,362,169	19	607,934	37	782,250	-	-	-	-	9,633,751
Statutory reserves	-	8,009,254	1,654,268	60,651	4,907,141	786,336	-	-	-	-	-	15,417,650
Investments restricted by Board	-	1,420,314	212,920	1,378,273	427,274	-	-	-	-	-	-	3,438,781
Pledges receivable, net	-	-	-	-	-	-	-	-	-	-	-	-
Funds held in trust	-	-	-	-	-	-	-	3,973,200	133,450	-	-	4,106,650
Beneficial interest in net assets of Foundation	-	10,807,344	1,304,392	112,486	2,474,804	1,073,378	315,157	-	-	-	(16,087,561)	-
Total assets	\$ 45,645,476	\$ 197,709,356	\$ 63,810,091	\$ 14,672,920	\$ 121,580,552	\$ 29,500,074	\$ 85,375,877	\$ 19,243,752	\$ 1,640,370	\$ 2,403,886	\$ (60,683,174)	\$ 520,899,180

(continued)

Asbury Communities, Inc.
Consolidating Balance Sheet (continued)

December 31, 2008

	Asbury Communities, Inc.	Asbury Methodist Village	Asbury Solomons, Inc.	Epworth Manor	Bethany Village	Springhill	Inverness Village, Inc.	Asbury Foundation, Inc.	Wesley Affiliated Services Foundation, Inc.	The Asbury Group, Inc.	Eliminations	Consolidated Balance
Liabilities and net deficit												
Current liabilities:												
Accounts payable and accrued expenses	\$ 4,930,281	\$ 898,676	\$ 106,036	\$ 284,823	\$ 569,483	\$ 104,861	\$ 272,577	\$ 11,974	\$ 95	\$ 369,869	\$ -	\$ 7,548,675
Accrued compensation and related items	8,933,350	-	-	17,094	-	747	-	-	-	1,116,766	-	10,067,957
Accrued interest payable	-	1,804,708	464,510	37,785	240,681	75,112	185,042	-	-	-	-	2,807,838
Construction retainage payable	-	-	-	-	659,590	-	-	-	-	-	-	659,590
Obligations under deferred-giving arrangements	-	-	-	-	162,048	-	-	681,830	-	-	-	843,878
Deposits from prospective residents	-	4,566,823	511,045	13,245	1,196,410	291,336	510,000	-	-	272,148	-	7,361,007
Entrance fees – refundable	-	581,245	231,203	-	76,017	4,571,995	1,448,326	-	-	-	-	6,908,786
Deferred revenue	-	170,032	51,859	21,912	46,729	13,716	8,851	-	-	75,076	-	388,175
Current portion of long-term debt	-	-	2,270,000	79,427	2,792,763	157,811	705,000	-	-	-	-	6,005,001
Total current liabilities	13,863,631	8,021,484	3,634,653	454,286	5,743,721	5,215,578	3,129,796	693,804	95	1,833,859	-	42,590,907
Due to ACOMM, net	-	-	8,423,111	-	9,245,830	4,171,818	18,327,379	-	-	-	(40,168,138)	-
Long-term debt, net	-	89,646,288	39,226,447	12,238,338	85,135,665	24,315,997	70,295,000	-	-	-	-	320,857,735
Projected refund of standard entrance fees	-	1,277,814	524,704	3,065	1,527,614	-	940,331	-	-	-	-	4,273,528
Entrance fees – deferred revenue	-	106,084,267	41,098,897	39,405	39,336,267	13,885,129	56,824,412	-	-	-	-	257,268,377
Valuation of derivative instruments	-	14,292,096	5,552,692	1,000,464	6,081,704	1,988,232	3,099,070	-	-	-	-	32,014,258
Obligation under deferred-giving arrangements	-	-	-	-	884,146	-	-	3,924,449	-	-	-	4,808,595
Other long-term liabilities	107,882	-	10,024	31,189	-	436	-	-	-	176,930	-	326,461
Total liabilities	13,971,513	219,321,949	98,470,528	13,766,747	147,954,947	49,577,190	152,615,988	4,618,253	95	2,010,789	(40,168,138)	662,139,861
Net assets (deficit):												
Unrestricted	31,673,963	(32,419,937)	(35,964,829)	402,480	(36,381,024)	(21,150,494)	(67,610,929)	150,000	-	393,097	(4,427,475)	(165,335,148)
Temporarily restricted	-	133,079	292,551	52,828	257,266	1,040,826	363,274	2,045,752	55,422	-	(2,101,174)	2,139,824
Permanently restricted	-	10,674,265	1,011,841	450,865	9,749,363	32,552	7,544	12,429,747	1,584,853	-	(13,986,387)	21,954,643
Total net deficit	31,673,963	(21,612,593)	(34,660,437)	906,173	(26,374,395)	(20,077,116)	(67,240,111)	14,625,499	1,640,275	393,097	(20,515,036)	(141,240,681)
Total liabilities and net deficit	\$ 45,645,476	\$ 197,709,356	\$ 63,810,091	\$ 14,672,920	\$ 121,580,552	\$ 29,500,074	\$ 85,375,877	\$ 19,243,752	\$ 1,640,370	\$ 2,403,886	\$ (60,683,174)	\$ 520,899,180

See accompanying notes.

Asbury Communities, Inc.
Consolidating Statement of Operations and Changes in Net Deficit

Year Ended December 31, 2008

	Asbury Communities, Inc.	Asbury Methodist Village	Asbury Solomons, Inc.	Epworth Manor	Bethany Village	Springhill	Inverness Village, Inc.	Asbury Foundation, Inc.	Wesley Affiliated Services Foundation, Inc.	The Asbury Group, Inc.	Eliminations	Consolidation
Revenues, gains and other support:												
Net resident-service revenue	\$ -	\$ 56,136,219	\$ 12,078,325	\$ 8,499,556	\$ 18,421,289	\$ 12,938,525	\$ 13,923,910	\$ -	\$ -	\$ -	\$ -	\$ 121,997,824
Other operating revenue	6,275,094	817,457	106,025	47,039	868,580	58,868	123,146	37,452	-	8,821,587	(12,366,541)	4,788,707
Amortization of entrance fees	-	10,698,631	3,556,418	4,812	3,421,210	322,521	3,007,218	-	-	-	-	21,010,810
Interest and dividend income, net	277,691	839,477	116,966	39,299	290,554	28,354	16,323	151,886	-	4,426	-	1,764,976
Net realized (losses) gains on investments	(85,966)	(213,582)	(8,175)	(17,980)	394,399	(6,108)	(17)	(124,971)	-	-	-	(62,400)
Proportionate share of (losses) earnings in equity interests funds	(1,726,533)	(3,297,620)	(160,692)	(273,453)	(905,624)	(70,047)	(271)	(1,091,247)	-	-	-	(7,525,487)
Other-than-temporary loss on investments	(4,263,543)	(8,143,224)	(396,816)	(675,272)	(2,790,227)	(172,977)	-	(2,701,549)	-	-	-	(19,143,608)
Contributions	-	-	-	-	-	-	-	1,976,893	(3,396)	-	-	1,973,497
Net assets released from restrictions used for operations	-	-	-	54,415	295,156	34,725	20,000	3,431,560	21,205	-	(3,573,212)	283,849
Total revenues, gains and other support	476,743	56,837,358	15,292,051	7,678,416	19,995,337	13,133,861	17,090,309	1,680,024	17,809	8,826,013	(15,939,753)	125,088,168
Expenses:												
Salaries	5,496,435	23,135,074	4,283,054	3,985,784	7,778,355	5,926,348	4,534,054	778,556	-	5,108,436	(284,017)	60,742,079
Employee benefits	813,980	5,441,837	793,185	1,208,948	1,875,389	1,420,441	1,080,421	121,757	-	690,016	(31,177)	13,414,797
Cost of goods sold	-	-	-	-	-	-	-	-	-	514,755	(89,294)	425,461
Contract labor	76,382	3,738,207	1,092,764	474,744	1,235,309	692,031	1,616,908	-	-	-	-	8,926,345
Food purchases	-	3,174,400	668,630	403,396	691,540	666,364	925,433	-	-	-	-	6,529,763
Medical supplies and other resident costs	-	2,542,056	473,073	537,282	799,036	567,732	598,913	-	-	-	-	5,518,092
General and administrative	2,229,875	1,842,969	491,186	195,853	431,068	386,604	655,666	580,976	5,790	1,079,896	(13,408)	7,886,475
Building and maintenance	477,021	6,653,162	1,696,727	660,115	2,406,050	1,099,046	1,598,480	28,215	-	1,531,040	(3,488)	16,146,368
Professional fees and property insurance	18,889	859,986	241,641	129,615	440,190	203,214	229,745	-	-	39,721	-	2,163,001
Interest	1,658	4,143,159	2,205,953	703,407	4,618,013	1,458,835	4,543,410	-	-	30,451	(1,129,576)	16,575,310
Taxes	1,269	1,293,915	595,172	(2,039)	430,777	267,826	640,366	1,457	-	(212,827)	-	3,015,916
Provisions for bad debts	-	1,681,001	96,908	75,349	132,199	171,008	187,666	(4,078)	11,241	20,560	-	2,371,854
Depreciation and amortization	57,068	8,833,412	2,268,628	574,016	3,573,013	2,122,205	2,870,281	7,177	-	734,947	(41,758)	20,998,989
Management fee	-	4,437,206	1,022,728	700,081	1,532,433	1,022,834	1,063,249	73,148	-	-	(9,851,679)	-
Transfers to (from) Asbury Foundation	-	3,174,865	393,246	-	-	-	5,101	-	-	-	(3,573,212)	-
Total expenses	9,172,577	70,951,249	16,322,895	9,646,551	25,943,372	16,004,488	20,549,693	1,587,208	17,031	9,536,995	(15,017,609)	164,714,450
(Loss) income from operations prior to net unrealized losses on change in market value of derivative instruments	(8,695,834)	(14,113,891)	(1,030,844)	(1,968,135)	(5,948,035)	(2,870,627)	(3,459,384)	92,816	778	(710,982)	(922,144)	(39,626,282)

(continued)

Asbury Communities, Inc.

Consolidating Statement of Operations and Changes in Net Deficit (continued)

Year Ended December 31, 2008

	Asbury Communities, Inc.	Asbury Methodist Village	Asbury Solomons, Inc.	Epworth Manor	Bethany Village	Springhill	Inverness Village, Inc.	Asbury Foundation, Inc.	Wesley Affiliated Services Foundation, Inc.	The Asbury Group, Inc.	Eliminations	Consolidation
(Loss) income from operations prior to net unrealized losses on change in market value of derivative instruments	\$ (8,695,834)	\$ (14,113,891)	\$ (1,030,844)	\$ (1,968,135)	\$ (5,948,035)	\$ (2,870,627)	\$ (3,459,384)	\$ 92,816	\$ 778	\$ (710,982)	\$ (922,144)	\$ (39,626,282)
Net unrealized losses on change in market value of derivative instruments	–	(6,343,942)	(3,187,811)	(574,519)	(3,492,589)	(1,159,023)	(2,473,444)	–	–	–	–	(17,231,328)
(Loss) income from operations	(8,695,834)	(20,457,833)	(4,218,655)	(2,542,654)	(9,440,624)	(4,029,650)	(5,932,828)	92,816	778	(710,982)	(922,144)	(56,857,610)
Net assets released from restriction used for purchase of equipment and capital items	–	–	–	–	–	–	–	106,264	–	–	–	106,264
Transfers to (from) affiliates	4,109,575	(6,167,478)	–	–	2,600,000	–	(435,833)	(106,264)	–	–	–	–
Net unrealized gains (losses) on investments	(536,063)	33,383	31,373	(23,451)	(376,771)	8,695	(680)	(92,816)	(778)	–	–	(957,108)
Net increase in unrestricted net deficit	\$ (5,122,322)	\$ (26,591,928)	\$ (4,187,282)	\$ (2,566,105)	\$ (7,217,395)	\$ (4,020,955)	\$ (6,369,341)	\$ –	\$ –	\$ (710,982)	\$ (922,144)	\$ (57,708,454)

See accompanying notes.