AMERICAN RETIREMENT CORP
Form 10-K
February 27, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

__X__ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2005
Commission file number 01-13031

American Retirement Corporation
(Exact Name of Registrant as Specified in its Charter)

Tennessee (State or Other Jurisdiction of Incorporation or Organization)	62-1674303 (I.R.S. Employer Identification No.)
111 Westwood Place, Suite 200, Brentwood, TN (Address of Principal Executive Offices)	37027 (Zip Code)
Registrant's Telephone Number, Including Area Code:	(615) 221-2250

Securities registered pursuant to Section 12(b) of the Act

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.01 per share	NYSE
Series A Preferred Stock Purchase Rights	NYSE

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Exchange Act of
1933. Yes o No þ

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No þ

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer as defined in Rule 12b-2 of the Securities Exchange Act of 1934. Large accelerated filer o Accelerated filer þ Non-Accelerated filer o

Indicate by check mark whether the Registrant is a shell company as defined in Rule 12b-2 of the Securities Exchange Act of 1934. Yes o No þ

The aggregate market value of common stock held by non-affiliates of the registrant as of June 30, 2005, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $360.7 million. The market value calculation was determined using a per share price of $14.62, the price at which the common stock was last sold on the New York Stock Exchange on such date. For purposes of this calculation, shares held by non-affiliates excludes only those shares beneficially owned by officers, directors, and shareholders owning 10% or more of the outstanding common stock (and, in each case, their immediate family members and affiliates).

The number of shares of the Registrant's common stock, $.01 par value per share, outstanding as of February 22, 2006, was 35,270,969.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for use in connection with the Annual Meeting of Shareholders to be held on May 17, 2006 are incorporated by reference into Part III, items 10, 11, 12, 13 and 14 of this Form 10-K.

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PART I

Item 1. Business

The Company

American Retirement Corporation is one of the largest operators of senior living communities in the United States. We are a senior living and health care services provider offering a broad range of care and services to seniors, including independent living, assisted living, skilled nursing and therapy services. The senior living industry is a growing and highly fragmented industry. We believe we are one of the few national operators providing a range of service offerings and price levels across multiple communities. We also offer a broad array of ancillary services, primarily through our Innovative Senior Care programs, which provide therapy, home health and other wellness services to our residents and to residents of other senior living communities. At December 31, 2005, we operated 76 senior living communities in 19 states, with an aggregate unit capacity of approximately 14,300 units and resident capacity of approximately 15,950. At December 31, 2005, we owned 26 communities (including 9 partially owned through joint ventures), leased 43 communities, and managed seven communities. Our revenues for the year ended December 31, 2005 were $495.0 million, of which approximately 83% was from private pay sources, 15% from Medicare and 2% from Medicaid.

We operate independent living communities, continuing care retirement communities, and free-standing assisted living communities primarily in large population centers. We have also developed specialized care programs for residents with Alzheimer's and other forms of dementia, and provide therapy services to many of our residents. We were established in 1978 and our operating philosophy was inspired by the vision of our founders, Dr. Thomas F. Frist, Sr. and Jack C. Massey, to enhance the lives of seniors by striving to provide the highest quality of care and services in well-operated communities designed to improve and protect the quality of life, independence, personal freedom, privacy, spirit, and dignity of our residents.

Recent Developments

Secondary Equity Offering

On January 24, 2006, we completed a public offering of 3,450,000 shares of our common stock, including the underwriter’s over-allotment of 450,000 shares. The shares were priced at $26.60. The net proceeds of the offering, after deducting underwriting discounts and commissions and expenses, were approximately $89.8 million. The proceeds from this offering were used to repay approximately $29.0 million of debt. The balance of the proceeds will be used to fund possible future acquisitions, to fund expansion activity, and for general corporate purposes, including working capital.

Acquisition of Independent Living Communities

On February 8, 2006, we announced that a joint venture in which we have an ownership interest had entered into a definitive asset purchase agreement with affiliates of Cypress Senior Living, Inc. to acquire four senior living communities located in two states for an aggregate purchase price of $146.3 million, subject to customary closing adjustments and transaction expenses. The communities have a capacity of 896 independent living units and are located in Arlington, Dallas and Ft. Worth, Texas and Leawood, Kansas.

The acquisition will be accomplished through two joint ventures, which will be owned 20% by us and 80% by an institutional real estate investor. The joint venture has obtained a firm commitment from Merrill Lynch Capital, a division of Merrill Lynch Business Financial Services Inc., to provide approximately $95.5 million of senior debt financing. The remainder of the purchase price will be funded by proportional capital contributions from the members of the joint venture entities. We will manage the portfolio pursuant to a long-term management agreement.

Operating Segments

We operate in three distinct business segments: retirement centers, free-standing assisted living communities, and management services.

Retirement Centers. We operate large continuing care retirement centers and independent living communities which we refer to as retirement centers, that provide a continuum of services, including independent living, assisted living, Alzheimer’s, memory enhancement and dementia programs and skilled nursing care. Our retirement centers include rental communities and entrance fee communities. We also offer a broad array of ancillary services, primarily through our Innovative Senior Care programs, which provide therapy and other wellness services to our residents and to residents of other senior living communities. Our retirement centers are large, often campus style or high-rise settings, with an average unit capacity of 311 units. These communities generally maintain high and consistent occupancy levels, many with waiting lists of prospective residents. Our retirement centers are the largest segment of our business and comprise 29 of the 76 communities that we operate, with unit capacity of approximately 9,000, representing approximately 63% of the total unit capacity of our communities. At December 31, 2005 and 2004, our retirement centers had an occupancy rate of 96%.

Free-standing Assisted Living Communities. Our free-standing assisted living communities provide specialized assisted living care to residents in a comfortable residential atmosphere. Most of the free-standing assisted living communities provide specialized care such as Alzheimer’s, memory enhancement and other dementia programs. These communities are designed to provide care in a home-like setting, which we believe residents prefer as opposed to the more clinical or institutional settings offered by some other providers. We provide personalized care plans for each resident, activity programs, and through our Innovative Senior Care programs, extensive wellness programs and therapy services. Our free-standing assisted living communities are much smaller than our retirement centers and had an average unit capacity of 94 units. As of December 31, 2005, we operated 41 free-standing assisted living communities, with unit capacity of approximately 3,800, representing approximately 27% of the total unit capacity of our communities. Twenty-seven of these free-standing assisted living communities had occupancy rates of 90% or better at December 31, 2005. Excluding nine communities partially owned through non-consolidated joint ventures, the 32 free-standing assisted living communities included in this segment had occupancy rates of 91% and 89% at December 31, 2005 and 2004, respectively.

Management Services. Our management services segment includes six large retirement centers owned by others and operated by us under multi-year management agreements. Under our management agreements for these six communities, we receive management fees as well as reimbursed expense revenues, which represent the reimbursement of certain expenses we incur on behalf of the owners. Two of these communities are retirement center cooperatives that are owned by their residents, and three others are owned by not-for-profit sponsors. The remaining managed retirement center is owned by an unaffiliated third party. These six communities have approximately 1,400 units, representing approximately 10% of the total unit capacity of our communities as of December 31, 2005.

We also operate a seventh retirement center, Freedom Square, under a long-term management agreement. In accordance with applicable accounting rules, the operating results of Freedom Square are included in the consolidated results of our retirement center segment.

We also manage nine free-standing assisted living communities in which we have a non-controlling minority ownership interest. Eight of these were acquired during November 2005 from the Epoch Senior Living group.

Operating results from these three business segments are discussed further in Management’s Discussion and Analysis of Financial Condition and Results of Operations and Note 18 to our consolidated financial statements.

Care and Services Programs

We provide a wide array of senior living and health care services at our communities, including independent living, assisted living and memory enhanced services (with special programs and living units for residents with Alzheimer's and other forms of dementia) and skilled nursing services. We also provide a broad array of ancillary services through our Innovative Senior Care program, including therapy services and other wellness programs. By offering a variety of services and involving the active participation of the resident, resident's family and medical consultants, we are able to customize our service plans to meet the specific needs and desires of each resident. As a result, we believe that we are able to maximize resident satisfaction and avoid the high cost of delivering all services to every resident without regard to need, preference, or choice.

Independent Living Services

We provide independent living services to seniors who do not yet need assistance or support with activities, but who prefer the physical and psychological comfort of a residential community for seniors that offers health care and other services. The independent living services we provide include daily meals and dining programs, transportation, social and recreational activities, laundry, housekeeping, security, and health care monitoring. We employ health care professionals to foster the wellness of our independent living residents by offering health screenings, ongoing dietary, exercise and fitness classes, and chronic disease management (such as diabetes with blood glucose monitoring). Subject to applicable government regulation, personal care and medical services are available to independent living residents. Our residency agreements with our independent living residents (other than entrance fee contracts) are generally for a term of one year (terminable by the resident upon 30 to 60 days written notice), although most residents remain for many years. The agreements generally provide for increases in billing rates each year (subject to specified ceilings at certain communities). Residents are also billed monthly for ancillary services utilized over and above those included in their recurring monthly service fees. These revenues are generally paid from private pay sources and are recognized monthly when the services are provided.

Assisted Living and Memory Enhanced Services

Residents who receive our assisted living services generally need assistance with some or all activities of daily living, but do not require the more acute medical care provided in a typical nursing home environment. Upon admission, each assisted living resident is assessed, in consultation with the resident, the resident's family and medical consultants, to determine his or her health status, including functional abilities and need for personal care services. Each resident also completes a lifestyles assessment to determine the resident's preferences. From these assessments, a care plan is developed in an effort to ensure that the specific needs and preferences of each resident are satisfied to the extent possible. Each resident's care plan is reviewed periodically to determine when a change in care is needed.

We have adopted a philosophy of assisted living care with the goal of allowing a resident to maintain a dignified, independent lifestyle. Residents and their families are encouraged to be partners in their care and to take as much responsibility for the resident’s well being as possible. The basic types of assisted living services offered by us include:

- *Personal Care Services* - which include assistance with daily activities such as ambulation, bathing, dressing, eating, grooming, personal hygiene, monitoring or assistance with medications, and confusion management;
- *Support Services* - such as meals, assistance with social and recreational activities, laundry services, general housekeeping, maintenance services and transportation services; and
- *Special Care Services* - such as our “Arbors” memory enhancement programs and other specialized services to care for residents with Alzheimer's and other forms of dementia in a comfortable, homelike setting.

We maintain programs and special “Arbors” units at most of our assisted living communities for residents with Alzheimer's and other forms of dementia. These programs provide the attention, care, and services to help those residents maintain a higher quality of life. Specialized services include assistance with activities of daily living, behavior management, and a lifeskills-based activity program, the goal being to provide a normalized environment that supports residents' remaining functional abilities. These special units are located in a separate area of the communities and have their own dining and lounge facilities, and specially trained staff.

Agreements for our assisted living services are month to month and provide for annual or other periodic increases to the monthly service fees. Monthly service fees are based on size of unit selected, additional services provided, and level of care required. Specialized units for those with Alzheimer’s or other forms of dementia have higher billing rates to cover the increased staffing and program costs associated with these services. These revenues, generally from private pay sources, are recognized as revenue on a monthly basis when the services are provided.

Skilled Nursing

Within our retirement center campuses, we operate seventeen skilled nursing centers providing traditional skilled nursing care by registered nurses, licensed practical nurses, and certified nursing aides. We also offer a range of therapy rehabilitation services in these communities. Therapy services are typically rendered immediately after, or in lieu of, acute hospitalization in order to treat specific medical conditions. Our skilled nursing services are primarily utilized by our independent and assisted living residents who occupy the skilled nursing centers at our retirement centers on a temporary or long-term basis. However, we also provide skilled nursing services to those admitted from outside the retirement center for temporary stays following hospitalization or other health issues, some of which also become long-term residents of the retirement center. These skilled nursing services are provided to the individuals on a daily fee basis, with additional charges for specialized equipment, therapy, medications or medical supplies in many cases. These services are paid for primarily by private pay sources, long-term care insurance, and, to a much lesser extent, under the Medicare, and in limited cases Medicaid, programs. Daily rates are revised periodically in response to cost changes and market conditions. These daily revenues are recognized when the services are provided.

Innovative Senior Care (Therapy Services)

We currently provide a range of education, wellness, and therapy services to our independent living, assisted living, and skilled nursing residents as part of our Innovative Senior Care programs, including our Care3 and Optimum Life service offerings. These programs are focused on wellness and physical fitness to allow residents to maintain maximum independence. These services provide many continuing education opportunities for residents and their families through health fairs, seminars, and other consultative interactions. The therapy services we provide include physical, occupational, speech and other specialized therapy services. In addition to providing these in-house therapy and wellness services at our communities, we also provide these services to other senior living communities that we do not own or operate. These services may be reimbursed under the Medicare program or paid directly by residents from private pay sources and revenues are recognized as services are provided.

Managed Communities

Our management agreements with third-parties have typical terms of three to twenty years and require us to provide a wide range of services. We may be responsible for providing all associates, and all marketing and operations services at the community. In other agreements, we may provide management personnel only, and more limited services including assistance with marketing, finance and other operations. In each case, the costs of owning and operating the community are the responsibility of the owner. In most cases, we receive a monthly fee for our services based either on a contractually fixed amount or a percentage of revenues or income. Our existing management agreements, many of which contain extension options, expire at various times through August 2020, but certain agreements may be canceled by the owner of the community, without cause, on three to six months written notice.

Entrance Fee Agreements

Seven of our retirement centers (three owned, three leased and one managed) are continuing care retirement centers that provide housing and health care services through entrance fee agreements with residents. These seven entrance fee communities are included in the consolidated results of our retirement centers. In addition, we manage three other retirement centers utilizing entrance fee agreements, but we do not receive the economic benefits of the entrance fee sales for these communities.

Under our entrance fee agreements, residents pay an entrance fee, typically $100,000 to $400,000 or more, upon initial occupancy of a unit. The amount of the entrance fee varies depending upon the type and size of the dwelling unit, the type of contract plan selected, whether the contract contains a lifecare benefit (healthcare discount) for the resident, the amount and timing of refund, and other variables. These agreements are subject to regulations in various states. Our entrance fee agreements are designed to provide housing and care for the remainder of a resident’s lifespan.

In addition to their initial entrance fee, residents under all of our entrance fee agreements also pay a monthly service fee, which entitles them to the use of certain amenities and certain services. Since we receive entrance fees upon initial occupancy, the monthly fees are generally less than fees at a comparable rental community. Residents may also elect to obtain additional ancillary services, which are billed on a monthly basis or as the services are provided. We recognize these additional fees as revenue on a monthly basis when these services are provided.

We generally categorize our entrance fee agreements as either traditional plans or “partner” plans, each of which are accounted for differently.

Traditional Plans - These agreements generally include limited lifecare benefits (healthcare discount) which are typically: (a) a certain number of free days in the community’s skilled nursing center during the resident’s lifetime; (b) a discounted rate for skilled nursing or assisted living services; or (c) a combination of the two. We offer a range of these types of contracts, including contracts with more limited healthcare discounts (and therefore generally higher percentage refunds at termination), and contracts with larger healthcare discounts (and therefore generally lower percentage refunds at termination).

Under our traditional plans, a portion of the entrance fee is generally refundable to the resident or the resident's estate upon termination of the entrance fee contract, with the refund being payable a specified number of days after contract termination. These agreements contain provisions reducing the percentage of the original entrance fee that is refundable to the resident over time. In a relatively short period of time (generally two to four years), the contractually refundable portion of the entrance fee is reduced from the original amount paid by the resident, down to the fixed minimum percentage stated in the agreement (which can range from zero to 100% of the total fee paid by the resident). For accounting purposes, we classify the fixed refundable portion of the entrance fee, which will be refundable regardless of when the contract terminates, as "refundable portion of entrance fees" on our balance sheet. The remaining portion of the entrance fee is recorded as "deferred entrance fee income" on our balance sheet and is amortized into our revenue using the straight-line method over the estimated remaining life expectancy of the resident, based upon actuarial projections.

The average length of stay of our entrance fee residents is ten to twelve years. Our experience shows that residents typically move in and spend the remainder of their lifespan at our entrance fee communities, with voluntary terminations by residents at de minimis levels (less than 3% per year). Our experience also shows that refunds due to prior residents or their estates are typically offset (with a substantial excess cushion) by resale of the vacant apartments to a subsequent residents.

Since termination of a resident's agreement can result under many contracts in a refund being due in less than one year, the refundable portion of these entrance fees (equal to the stated fixed minimum refund percentage) is recorded on our balance sheet as a current liability, although we do not believe that payment of these liabilities will typically require use of our current cash balances, but instead will be offset by the proceeds of future entrance fee sales. The deferred entrance fee income is generally classified as a long-term liability on our balance sheet, with a portion shown as a current liability during the early years of a resident's agreement (until the contractual provisions of the agreement reduce the potential refund to the fixed minimum percentage stated in the agreement).

Partner Plans - At certain of our entrance fee communities, we maintain an entrance fee program known as the "partner plan" which allows the resident to participate in the appreciation in the value of the resident's unit. Under our partner plans, the entrance fee is refundable to the resident or the resident's estate only upon the sale of the unit to a succeeding resident unless otherwise required by applicable state law. Typically, partner plan residents receive priority access to assisted living and skilled nursing services, but no discounted or other lifecare benefits. The resident shares in a specified percentage, typically 50%, of any appreciation in the entrance fee paid by the succeeding resident. The entire entrance fee under a partner plan is recorded as deferred entrance fee income and is amortized into revenue using the straight-line method over the remaining life of the building. The deferred entrance fee income for partner plans is shown as a long-term liability on our balance sheet.

Business Operations

Management Structure

Each of our retirement centers is managed by an executive director, with various department heads responsible for functional areas such as assisted living, activities, dining services, maintenance, human resources and finance. Within the retirement centers, healthcare professionals manage the assisted living and memory enhanced programs, as well as wellness and other programs. For those communities with health centers providing skilled nursing services, licensed professionals also manage those services and direct the nursing staff.

Each of the free-standing assisted living communities is managed by a residence manager whose primary focus is resident care. These communities receive daily administrative central support for operations, care planning, clinical assessments, quality assurance, accounting and finance, human resources, dining and maintenance. By providing strong program management and administrative support from the home office and at the regional level, the staff at the free-standing assisted living communities can focus on the care of the residents and interaction with their families or other caregivers.

The retirement centers and free-standing assisted living communities report to regional operations vice presidents. These regional vice presidents and their staff regularly visit the communities, providing inspection of the communities, staff development and training, financial and program reviews, regulatory and compliance support, and quality assurance reviews.

Our home office provides central support to the communities in various areas, including information technology, human resources, training, accounting, finance, internal audit, insurance and risk management, legal, development, sales and marketing, dining services, therapy services, operations and program support, and national purchasing programs. Home office staff also provides support for budgeting, financial analysis and strategic planning. In addition, quality assurance and risk management staff review and monitor key safety and quality measurements, train community staff, and visit communities regularly for regulatory and other compliance programs. Human resource programs are developed for staff training and retention in the communities, and are implemented by the home office and regional staff.

Our belief is that, through our regional and home office staff and because of our scale, we are able to provide strong support in each functional area on a cost effective basis, which provides an advantage over many other smaller or local competitors. In addition, by providing daily administrative support to our free-standing assisted living communities we believe that our community staff is able to stay focused on resident care and provide a higher level of service to the residents and their families.

Marketing

Each community has an on-site marketing director, and additional marketing staff based on its size. These community based marketing personnel are involved in daily activities with prospective residents and key referral sources including current residents and their families. Home office and regional marketing directors assist each community in developing, implementing and monitoring their detailed marketing plan. The marketing plans include goals for lead generation, wait lists, referrals, community outreach, awareness events, prospect follow-up, and monthly move-ins. Competitive analyses are also updated regularly. Home office marketing staff provide coordination and monitoring of these marketing plans, development of pricing strategies and overall marketing plans, marketing planning and support for upcoming expansions and developments, assistance with creative media, collection and analysis of data measuring effectiveness of promotions, advertising, and lead sources, and selection and training of regional and community staff. Our belief is that this locally based marketing approach, coupled with strong regional and central monitoring and support, provides an advantage over many smaller or regional competitors.

Feedback and Quality Assurance

We solicit regular feedback from our residents, their families, and our associates through various satisfaction surveys. We also regularly perform quality assurance reviews by community, regional and home office staff, in addition to being subject to surveys and reviews by various local, state and federal regulatory agencies. Our belief is that each of these activities provides important feedback, which can be used by management to maintain high levels of safety and quality, and to continue to look for opportunities to improve our procedures and programs.

Senior Living Industry

The senior living industry is highly fragmented and characterized by numerous local and regional operators. We are one of a limited number of national competitors that provide a broad range of community locations and service level offerings at varying price levels. The industry has seen significant growth in recent years and has been marked by the emergence of the assisted living segment in the mid-1990s.

We believe that a number of trends will contribute to the growth in the senior living industry. The primary market for senior living services is individuals age 75 and older. According to U.S. Census data, this group is one of the fastest growing segments of the United States population and is expected to more than double between the years 2000 and 2030. The population of seniors age 85 and over has also increased in recent years, and is expected to continue to grow. As a result of these expected demographic trends, we expect an increase in the demand for senior living services in future years. In addition, the aggregate home equity held by seniors age 75 and over has grown significantly in recent years, which has greatly increased the number of seniors who can afford our services.

We believe the senior living industry has been and will continue to be impacted by several other trends. The use of long-term care insurance is increasing among current and future seniors as a means of planning for the costs of senior living services. In addition, as a result of increased mobility in society, reduction of average family size, and increased number of two-wage earner couples, more seniors are looking for alternatives outside of their family for their care. Many seniors have also shown an increasing preference for communities that allow them to “age in place” in a residential setting, which provides them maximum independence and quality of life in contrast to more institutional or clinical settings. The emergence of the assisted living segment of the industry in the mid-1990s is a prime example of this trend.

Competition

The senior living and health care services industry is highly competitive and we expect that providers within the industry will continue to be competitive in the future. We believe that the primary competitive factors in the senior living and health care services industry are: (i) reputation for and commitment to a high quality of care; (ii) quality of support services offered; (iii) price of services; (iv) physical appearance and amenities associated with the communities; and (v) location. We compete with other companies providing independent living, assisted living, skilled nursing, and other similar service and care alternatives.

The senior living industry is highly fragmented and characterized by many local or regional operators. We are one of a limited number of national competitors that operate a large number of communities in multiple locations, and that provide a broad range of senior living services at varying price levels. Our size allows us to centralize administrative functions that give the decentralized managerial operations cost-efficient support. We believe we have a reputation as a leader in the industry and as a provider of high quality services.

We also compete with other health care businesses with respect to attracting and retaining high quality professionals including nurses, therapists, technicians, aides, managers and other associates. The market for these professionals has become very competitive, with resulting pressure on salaries and compensation levels. However, we believe that we are able to attract and retain quality associates through our reputation, culture, organizational stability, and competitive compensation.

Business Strategy

Our business strategy is to provide high-quality services to seniors at reasonable prices, maintain strong competitive positions and build critical mass in each of our key markets, and to enhance the value of our communities by expanding services and improving operating results. We plan to implement this business strategy primarily through the following steps.

Growth Through Expansion and Development:

We currently have nine active expansion projects and four active development projects in process, including our managed communities which represent approximately 1,500 units additional capacity. Many of these are in the construction stage, and several are expected to open during the second half of 2006. Our four development projects include:

- Development of two entry fee continuing care retirement centers near Austin, TX and Villages, FL, on the sites of our two existing assisted living communities (The Villages is a large active seniors planned community north of Orlando).
- Development of a rental continuing care retirement center in Denver, CO through a joint venture.
- Development of a free-standing assisted living community in Nashville, TN for a non-profit senior living company.

In addition, we have approximately 750 additional units at six communities which are in the active planning stage, typically working through the design, zoning and entitlement processes. We also have identified numerous other expansion opportunities (in excess of 1,000 additional units) which are in the preliminary planning stage, and may provide opportunities for additional future growth.

Growth Through Acquisition:

We expect to periodically look for opportunities to acquire other senior living communities, particularly focused on building critical mass within our markets. We believe that by having a network of communities within a market, it gives us the critical mass to efficiently provide various ancillary service programs. We will look to enhance our value by adding both retirement centers and free-standing assisted living communities in selected markets. We may consider certain projects through joint ventures or long-term management contracts.

Expand Our Ancillary Service Programs:

We offer a range of therapy, home health and wellness programs to our residents, primarily through our Innovative Senior Care programs, including our Care3 and Optimum Life service offerings. We also have contracts to provide these services to other senior living communities in our markets. We believe that having critical mass in a market through a network of communities is important for the success and growth of our ancillary service programs. We provide a broad range of other ancillary services, and have recently partnered with others for expanded service offerings in telecommunications and pharmacy services. We expect to continue to grow these ancillary service revenues, which should increase our revenue per unit in the future.

Improve Our Community Results:

- Our free-standing assisted living segment occupancy was 91% at December 31, 2005. We are focused on further increasing the occupancy in these communities as well as selected retirement centers. We expect that further occupancy increases will not require significant incremental cost increases, and therefore will result in high incremental operating margins.
- We expect that revenue per unit will increase in the future as a result of increased ancillary service revenues, price increases, and the “mark-to-market” effect of resident turnover as residents with lower rates are replaced by those paying higher current selling rates. We expect to recover operating cost increases through periodic price increases as we have in the past.
- We will continue to actively market the units in our entrance fee communities, and increase prices, subject to market conditions, in response to increased home values and equity in selected markets. The net resale cash flow from selling entrance fee units at current prices, net of percentage refunds generally paid to estates of prior residents, provides a significant source of cash each year.

Maintain a Platform for Operating Excellence and Growth:

By focusing on areas we believe are key drivers in our business, we believe we have formed a platform that not only supports operating excellence at our existing communities, but also readily supports the growth of our portfolio through acquisition, expansion and development.

Quality Assurance and Risk Management - We place a high priority on and devote a significant amount of resources to quality assurance, safety, and risk management. As a result of our scale, we are able to provide cost effective insurance programs, training programs, information systems support, and quality assurance programs. We believe that the expertise we have developed may provide a competitive advantage over smaller competitors unable to devote similar effort and resources in this important area.

People - As a service oriented business with high labor requirements, we will continue to focus on attracting and retaining high quality personnel to ensure we are delivering high quality services in a cost effective manner. In order to be successful in our effort, we have dedicated in-house recruiters to find the right people, designed programs to improve retention of associates, and conducted training programs to ensure our associates are trained to excel in their roles. We also believe that the significant industry experience and tenure of our senior management team is also one of our strengths.

Systems - We have developed certain proprietary systems to provide our managers with timely access to the information necessary to manage and control pricing levels, unit inventory levels, and the turnover and retention of associates. We believe that these systems provide strategic value in managing our business, and are readily scalable to support its growth. In addition, they are designed to be implemented quickly in order to integrate newly acquired communities into our portfolio.

Marketing and Sales - We strive to excel at the marketing and sales of senior living communities. We have developed various programs focused on generating referrals to our communities, which provide a very effective referral source of new move-ins. Based on our years of experience, we also believe we are very successful at planning and implementing the proper positioning, pricing, and service level package at our existing and newly acquired communities.

Government Regulation

Senior living companies are subject to various federal, state and local regulations, which are frequently revised. While such requirements vary by state, they typically regulate, among other matters, the number of licensed beds, provision of services, staffing levels, professional licensing, distribution of pharmaceuticals, billing practices, equipment, operating procedures, environmental matters, and compliance with building and safety codes. Our communities are also subject to various zoning restrictions, local building codes, and other ordinances, such as fire safety codes. Certain states require a certificate of need review in order to provide skilled nursing or other services. Currently, the operation of independent living and assisted living residences are subject to limited federal and state laws, although regulation has increased in recent years. We believe that the regulation of assisted living services may increase in the future.

Our skilled nursing centers and home health agencies are subject to Federal certification requirements in order to participate in the Medicare and Medicaid programs. Approximately 16.5%, 14.9%, and 13.3% of our total revenues for the years ended December 31, 2005, 2004, and 2003, respectively, were attributable to Medicare, including Medicare-related private co-insurance, and a small amount of Medicaid. These reimbursement programs are subject to extensive regulation and frequent change, which may be beneficial or detrimental to us. As of January 1, 2006, certain per person annual limits on Medicare reimbursement for therapy services became effective, subject to certain exceptions. Although we are awaiting final regulatory and administrative procedures, these limits will reduce certain portions of our therapy services revenues and the profitability of those services. There continue to be various federal and state legislative and regulatory proposals to implement cost containment measures that would limit payments to healthcare providers in the future. Changes in the reimbursement policies of the Medicare program could have an adverse effect on our results of operations and cash flow.

In addition, there are various Federal and state laws prohibiting other types of fraud and abuse by health care providers, including criminal and civil provisions that prohibit filing false claims or making false statements to receive payment or certification under Medicare or Medicaid and failing to refund overpayments or improper payments. Violation of these laws can result in loss of licensure, civil and criminal penalties, and exclusion of health care providers or suppliers from participation in Medicare, Medicaid, and other state and Federal reimbursement programs.

Our entrance fee communities are subject to regulation by certain state departments of insurance and various state agencies, and must meet various financial and other guidelines and disclosure requirements.

Many of our communities are subject to periodic survey or inspection by governmental authorities. From time to time in the ordinary course of business, one or more of our communities may be cited for operating or other deficiencies by regulatory authorities. Although most inspection deficiencies can be resolved through a plan of correction, the regulatory agency may have the right to levy fines, impose conditions on operating licenses, suspend licenses, or propose other sanctions for the facility.

There are currently numerous legislative and regulatory initiatives at the state and Federal levels addressing patient privacy concerns, including regulations regarding privacy and security under the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"). These regulations restrict how health care providers use and disclose individually identifiable health information and grant patients certain rights related to their health information. Final HIPAA security regulations became effective in April 2005 and govern the security of individually identifiable health information that is electronically maintained or transmitted. Failure to comply with the privacy, security or transaction standard regulations enacted under HIPAA can result in civil and criminal penalties. We do not expect costs incurred, or costs to be incurred in order to continue compliance with HIPAA to have a material impact on our operating results.

Insurance

The delivery of personal and health care services entails an inherent risk of liability. Participants in the senior living and health care services industry have become subject to an increasing number of lawsuits alleging negligence or related legal theories, many of which involve large claims and result in the incurrence of significant exposure and defense costs. Currently, we maintain general and professional medical malpractice insurance policies for our owned, leased and certain of our managed communities under a master insurance program. Premiums and deductibles for this insurance coverage have risen dramatically in recent years. In response to these conditions, we have significantly increased the staff and resources involved in quality assurance, compliance and risk management during the past several years, and have also modified our insurance programs. During 2005, we maintained single incident and aggregate liability protection in the amount of $25.0 million for general liability and $15.0 million for professional liability, with self-insured retentions of $1.0 million and $5.0 million, respectively, with a larger self-insured component and decreased premiums over 2004. Beginning January 2006, we formed a wholly-owned “captive” insurance company for the purpose of insuring certain portions of our risk retention under our general and professional liability insurance programs. Our captive insurance company is subject to applicable reserve requirements and regulations.

As of December 31, 2005, the Company’s coverage for workers’ compensation and related programs, excluding Texas, included excess loss coverage in an aggregate amount of $6.3 million with a deductible amount of $350,000 per individual claim. As of December 31, 2005, the Company provided cash collateralized letters of credit in the aggregate amount of $8.2 million related to this program, which are reflected as restricted cash on the Company’s consolidated balance sheet. For work-related injuries in Texas, the Company is a non-subscriber under Texas state law, meaning that work-related losses are covered under a defined benefit program outside of the Texas Workers' Compensation system. The Company carries excess loss coverage of $1.0 million per individual, with a deductible of $250,000 under its non-subscriber program. Losses are paid as incurred and estimated losses are accrued on a monthly basis. The Company utilizes a third party administrator to process and pay filed claims.

We also maintain a self-insurance program for employee medical coverage, with stop-loss insurance coverage of amounts in excess of $250,000 per associate. Estimated costs related to these self-insurance programs are accrued based on known claims and projected settlements of unasserted claims incurred but not yet reported. Subsequent changes in actual experience (including claim costs, claim frequency, and other factors) could result in adjustments to these estimates.

Given our high retention levels and our captive insurance company, we are largely self-insured for typical claims. In addition, there can be no assurance that a claim in excess of our insurance coverage limits will not arise. A claim against us not covered by, or in excess of, our coverage limits could have a material adverse effect. Furthermore, there can be no assurance that we will be able to obtain liability insurance in the future on acceptable terms.

Employees

At December 31, 2005, we employed 10,400 associates, of which approximately 6,750 were full-time employees. We believe that our relationship with our associates is good.

Executive Officers of the Registrant

The following table sets forth certain information concerning our executive officers.

Name	*Age*	*Position*
W. E. Sheriff	63	Chairman, Chief Executive Officer and President
Gregory B. Richard	52	Executive Vice President and Chief Operating Officer
Bryan D. Richardson	47	Executive Vice President - Finance and Chief Financial Officer
George T. Hicks	48	Executive Vice President - Finance and Internal Audit, Secretary and Treasurer
H. Todd Kaestner	50	Executive Vice President - Corporate Development
James T. Money	56	Executive Vice President - Sales and Marketing
Terry L. Frisby	55	Senior Vice President - Human Resources/Corporate Culture and Compliance
Jack Leebron	56	Senior Vice President - Legal Services
Ross C. Roadman	55	Senior Vice President - Strategic Planning and Investor Relations
E. Carl Johnson	55	Senior Vice President - Development

W.E. Sheriff has served as Chairman and Chief Executive Officer of our Company and our predecessors since April 1984 and as our President since 2003. From 1973 to 1984, Mr. Sheriff served in various capacities for Ryder System, Inc., including as President and Chief Executive Officer of its Truckstops of America division. Mr. Sheriff also serves on the boards of various educational and charitable organizations and in varying capacities with several trade organizations.

Gregory B. Richard has served as our Executive Vice President and Chief Operating Officer since January 2003 and previously served as our Executive Vice President - Community Operations since January 2000. Mr. Richard was formerly with a pediatric practice management company from May 1997 to May 1999, serving as President and Chief Executive Officer from October 1997 to May 1999. Prior to this, Mr. Richard was with Rehability Corporation, a publicly traded outpatient physical rehabilitation service provider, from July 1986 to October 1996, serving as Senior Vice President of Operations and Chief Operating Officer from September 1992 to October 1996.

Bryan D. Richardson has served as our Executive Vice President - Finance and Chief Financial Officer since April 2003 and previously served as our Senior Vice President - Finance since April 2000. Mr. Richardson was formerly with a national graphic arts company from 1984 to 1999 serving in various capacities, including Senior Vice President of Finance of a digital prepress division from May 1994 to October 1999, and Senior Vice President of Finance and Chief Financial Officer from 1989 to 1994. Mr. Richardson was previously with the national public accounting firm PriceWaterhouseCoopers.

George T. Hicks has served as our Executive Vice President - Finance and Internal Audit, Secretary and Treasurer since September 1993. Mr. Hicks has served in various capacities for our predecessors since 1985, including Chief Financial Officer from September 1993 to April 2003 and Vice President - Finance and Treasurer from November 1989 to September 1993.

H. Todd Kaestner has served as our Executive Vice President - Corporate Development since September 1993. Mr. Kaestner has served in various capacities for our predecessors since 1985, including Vice President - Development from 1988 to 1993 and Chief Financial Officer from 1985 to 1988.

James T. Money has served as our Executive Vice President - Sales and Marketing since September 1993. Mr. Money has served in various capacities for our predecessors since 1978, including Vice President - Development from 1985 to 1993.

Terry L. Frisby has served as our Senior Vice President - Human Resources/Corporate Culture and Compliance since January 1999. Mr. Frisby served as Vice President - Corporate Culture and Compliance from July 1998 to January 1999. Prior to this, Mr. Frisby was principal of a healthcare consulting business located in Nashville, Tennessee, from 1988 to 1998. Mr. Frisby serves on the Executive Council for Human Resources with the Assisted Living Federation of America.

Jack Leebron has served as our Senior Vice President - Legal Services since May 2004. Mr. Leebron served as Vice President of Legal Services from May 2003 to May 2004. Mr. Leebron's prior positions include five years as General Counsel to Regency Pacific, Inc., General Counsel to Bryant Exploration Company, and the private practice of law for 16 years. He presently holds current licensure to practice law in Colorado, Washington, Oklahoma and Tennessee. He is a member of the Tennessee Bar Association, the Oklahoma Bar Association, the Washington Bar Association, the American Health Lawyers Association, the Risk and Insurance Management Society, Inc., and the Association of Corporate Counsel.

Ross C. Roadman has served as our Senior Vice President - Strategic Planning and Investor Relations since May 1999. Previously, Mr. Roadman served in various capacities, since 1980, at Ryder System, Inc., including as Group Director of Investor and Community Relations, Assistant Treasurer, Division Controller, and Director of Planning.

Before joining Ryder, he held positions with Ernst & Young and the International Monetary Fund. He serves on the boards of several educational and charitable organizations as well as being active in various professional organizations.

E. Carl Johnson has served as our Senior Vice President - Development since September 2005. Mr. Johnson was previously Co-Founder and Chief Operating Officer of LifeTrust America from 1996 to December 2004. LifeTrust America was the owner and operator of 59 Senior Independent and Assisted Living properties in 8 states. He served as a member of the Board of Directors of the National Assisted Living Federation (ALFA) and was a charter member of the Kentucky ALFA chapter. Before joining LifeTrust, Mr. Johnson was President of Health Information Associates, a subsidiary of Hospital Corporation of America.

Available Information

Our internet website address is http://www.arclp.com. Our website address is provided as an inactive textual reference only. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports are available free of charge through our website as soon as reasonably practicable after such forms, reports or materials are electronically filed with or furnished to the Securities and Exchange Commission. Information contained on our website is not part of this report, and is not incorporated by reference.

We have posted our Corporate Governance Guidelines, Code of Business Conduct and Ethics, and the charters of our Audit, Compensation, Executive, Nominating and Corporate Governance and Quality Assurance Committees on our website at http://www.arclp.com. Our corporate governance materials are available in print free of charge to any shareholder upon request to our Corporate Secretary, American Retirement Corporation, 111 Westwood Place, Suite 200, Brentwood, Tennessee 37027.

Our code of ethics that applies to each principal executive officer, principal financial officer, principal accounting officer or controller and persons performing similar functions is also available on our website.

Item 1A. Risk Factors

Risks Associated with Forward Looking Statements

This Form 10-K contains certain forward-looking statements within the meaning of the federal securities laws, which are intended to be covered by the safe harbors created thereby. Those forward-looking statements include all statements that are not historical statements of fact and those regarding our intent, belief or expectations including, but not limited to, all statements concerning our anticipated improvement in operations and anticipated or expected cash flow; our expectations regarding trends in the senior living industry; the discussions of our operating and growth strategy; our liquidity and financing needs; our expectations regarding future entrance fee sales or increasing occupancy at our retirement centers or free-standing assisted living communities; our alternatives for raising additional capital and satisfying our periodic debt and lease obligations; our projections of revenue, income or loss, capital expenditures, interest rates, and future operations; our anticipated expansions, development or acquisition activity; and the availability of insurance programs to us or the adequacy of such programs. All forward-looking statements involve risks and uncertainties including, without limitation, the risks and uncertainties described in this report under Item 1A. “Risks Related to Our Business.”

Should one or more of those risks materialize, actual results could differ materially from those forecasted or expected. Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of these assumptions could prove to be inaccurate, and therefore, there can be no assurance that the forward-looking statements included in this Form 10-K will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our forecasts, expectations, objectives or plans will be achieved. We undertake no obligation to publicly release any revisions to any forward-looking statements contained herein to reflect events and circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events.

Risks Related to Our Business

We have substantial debt and operating lease obligations which will require significant amounts of cash each year.

We have substantial debt and lease obligations. Our cash needs for our lease and interest payments and principal payments on outstanding debt will remain high for the foreseeable future. At December 31, 2005, we had long-term debt, including current portion, of $324.0 million. During the twelve months ending December 31, 2006, we are obligated to pay minimum rental obligations of approximately $68.2 million under long-term operating leases and have current scheduled debt principal and lease payments of $28.8 million. At December 31, 2005, we had $40.8 million of unrestricted cash and cash equivalents, $28.4 million of restricted cash and $90.5 million of negative working capital. For the year ended December 31, 2004, our net cash provided by operations was $60.8 million. There can be no assurance that we will be able to generate sufficient cash flows from operations and entrance fee sales to meet required interest, principal, and lease payments in future periods.

Certain of our debt agreements and leases contain various financial and other restrictive covenants, which may limit our flexibility in operating our business. Any payment or other default with respect to such obligations could cause lenders to accelerate payment obligations or to foreclose upon our communities securing such indebtedness or, in the case of any of our operating leases, terminate the lease, with a consequent loss of income and asset value to us. Furthermore, because of cross-default and cross-collateralization provisions in certain debt instruments and leases, a default by us on one of our obligations could result in default or acceleration of other obligations. Failure to remain in compliance with the covenants and obligations contained in our debt instruments and leases could have a material adverse impact on us.

Our liability insurance may not be adequate to cover claims which may arise against us.

The delivery of personal and health care services entails an inherent risk of liability. In recent years, participants in the senior living and health care services industry have become subject to an increasing number of lawsuits alleging negligence or related legal theories, many of which involve large claims and result in the incurrence of significant exposure and defense costs. Currently, we maintain general and professional medical malpractice insurance policies for our owned, leased and certain of our managed communities under a master insurance program. Premiums and deductibles for this insurance coverage have risen dramatically in recent years. We are largely self-insured for typical claims. In response to these conditions, we have significantly increased the staff and resources involved in quality assurance, compliance and risk management during the past several years, and have also modified our insurance programs. We cannot assure you that our current level of accruals will be adequate to cover the actual liabilities that we may ultimately incur. We also cannot assure you that a claim in excess of our insurance coverage limits will not arise. A claim against us that is not covered by, or is in excess of, our coverage limits could have a material adverse effect upon us. Furthermore, we cannot assure you that we will be able to obtain adequate liability insurance in the future or that, if such insurance is available, it will be available on acceptable terms.

We rely on reimbursement from governmental programs for a portion of our revenues, and are subject to changes in reimbursement levels, which could adversely affect our results of operations and cash flow.

We rely on reimbursement from governmental programs for a portion of our revenues, and we cannot assure you that reimbursement levels will not decrease in the future, which could adversely affect our results of operations and cash flow. For the year ended December 31, 2005, we derived 15% of our revenues from Medicare and 2% from Medicaid. As of January 1, 2006, certain per person annual limits on Medicare reimbursement for therapy services became effective, subject to certain exceptions. Although we are awaiting final regulatory and administrative procedures, these limits will reduce certain portions of our therapy services revenues and the profitability of those services. There continue to be various federal and state legislative and regulatory proposals to implement cost containment measures that would limit payments to healthcare providers in the future. Changes in the reimbursement policies of the Medicare program could have an adverse effect on our results of operations and cash flow.

We may be adversely affected by the limited availability of management, nursing and other personnel for our communities and by increased labor costs.

We compete with other providers of senior living and health care services with respect to attracting and retaining qualified management personnel responsible for the day-to-day operations of each of our communities and skilled technical personnel responsible for providing resident care and therapy services. In certain markets, a shortage of nurses, therapists or trained personnel has required us to enhance our wage and benefits package in order to compete in the hiring and retention of such personnel or to hire more expensive temporary personnel. We are also heavily dependent on the available labor pool of semi-skilled and unskilled associates in each of the markets in which we operate. At times, we have experienced a competitive labor market, periodic shortages of qualified workers in certain markets, and wage rate increases for certain of our associates. We cannot be sure that our labor costs will not increase, or that, if they do increase, they can be matched by corresponding increases in rates charged to residents. If we are unable to attract and retain qualified management and staff personnel, control our labor costs, or pass on increased labor costs to residents through rate increases, our business, financial condition, and results of operations would be adversely affected.

We may be adversely affected by rising interest rates.

Future indebtedness, from commercial banks or otherwise, and lease obligations, including those related to communities leased from REITs (real estate investment trusts), are expected to be based on interest rates prevailing at the time such debt and lease arrangements are obtained. As of December 31, 2005, we had $239.1 million of fixed rate debt and $84.9 million of variable rate debt outstanding. Increases in prevailing interest rates would increase our interest obligations with respect to a substantial portion of our variable rate debt, and would likely increase our interest and lease payment obligations on our future indebtedness and leases. An increase in prevailing interest rates, if material, could have a material adverse effect on our business, financial condition, and results of operations.

We may be unable to refinance debt obligations on acceptable terms.

We may need to refinance certain future debt maturities as they come due. Our ability to refinance debt obligations may be impacted by our operational results, industry and economic conditions, capital market conditions, and other factors that may not be within our control. Our inability to refinance various debt maturities as they come due in future years on acceptable terms could have an adverse impact on us and our financial condition.

We may not be able to successfully integrate acquired communities and new managed communities into our operations, which could adversely affect our business, financial condition and results of operations.

During the past year, we have completed several acquisitions of retirement communities and have entered into agreements to manage other communities. We also expect to complete acquisitions and enter into new management agreements in the future. Achieving the expected benefits of these acquisitions and new management agreements will depend in large part on our completion of the integration of the operations and personnel of the new communities in a timely and efficient manner. If we cannot overcome the challenges we face in completing the integration, our ability to effectively and profitably manage the new communities could suffer. Moreover, the integration process itself may be disruptive to our business, as it will divert the attention of management from its normal operational responsibilities and duties. We cannot offer any assurance that we will be able to successfully integrate the new communities' operations or personnel or realize the anticipated benefits of the acquisitions and new management agreements. Our failure to successfully complete the integration could harm our business, financial condition and results of operations.

If we are unable to expand our communities in accordance with our plans, our anticipated revenues and results of operations could be adversely affected.

We are currently working on projects that will expand several of our existing senior living communities over the next several years, and develop certain new senior living communities. These projects are in various stages of development and are subject to a number of factors over which we have little or no control. Such factors include the necessity of arranging separate leases, mortgage loans or other financings to provide the capital required to complete these projects; difficulties or delays in obtaining zoning, land use, building, occupancy, licensing, certificate of need and other required governmental permits and approvals; failure to complete construction of the projects on budget and on schedule; failure of third-party contractors and subcontractors to perform under their contracts; shortages of labor or materials that could delay projects or make them more expensive; adverse weather conditions that could delay completion of projects; increased costs resulting from general economic conditions or increases in the cost of materials; and increased costs as a result of changes in laws and regulations.

We cannot assure you that we will elect to undertake or complete all of our proposed expansion and development projects, or that we will not experience delays in completing those projects. In addition, we may incur substantial costs prior to achieving stabilized occupancy for each such project and cannot assure you that these costs will not be greater than we have anticipated. We also cannot assure you that any of our development projects will be economically successful. Our failure to achieve our expansion and development plans could adversely impact our growth objectives, and our anticipated revenues and results of operations.

The senior living industry is very competitive and has been subject to periodic oversupply conditions, which could have a material adverse effect on our revenues, earnings and expansion plans.

The senior living industry is highly competitive. We compete with other companies providing independent living, assisted living, skilled nursing, therapy and other similar services and care alternatives. We expect that there will be competition from existing competitors and new market entrants, some of whom may have substantially greater financial resources than us. In addition, some of our competitors operate on a not-for-profit basis or as charitable organizations and have the ability to finance capital expenditures on a tax-exempt basis or through the receipt of charitable contributions, neither of which is available to us. Furthermore, if the development of new senior living communities outpaces the demand for those communities in the markets in which we have senior living communities, those markets may become saturated or over-built. Regulation of the independent and assisted living industry, which represents a substantial portion of our senior living services, currently is not substantial and does not represent a significant barrier to entry. Consequently, the development of new senior living communities could outpace demand. Increased competition for residents could also require us to undertake unbudgeted capital improvements or to lower our rates. An oversupply of senior living communities in our markets or increased competition could adversely affect our business and results of operations.

We may be adversely affected by the loss of our key officers or associates.

We rely upon the services of our executive officers. The loss of our executive officers and the inability to attract and retain qualified management personnel could affect our ability to manage our business and could adversely affect our business, financial condition and results of operations.

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We may be adversely affected by the termination of residency and care agreements with our residents.

Our residency and care agreements with our independent living residents (other than entrance fee contracts) are generally for a term of one year (terminable by the resident upon 30 to 60 days written notice). Although most residents remain for many years, we do not contract with residents for longer periods of time. If a large number of residents elected to terminate their resident agreements at or around the same time, our revenues and earnings could be adversely affected. Although most entrance fee residents remain for many years, our entrance fee agreements are also terminable upon death or with thirty days notice. If a large number of entrance fee agreements were terminated around at approximately the same time, triggering certain refund liabilities, and we were unable to resell the apartment units quickly or at reasonable price levels, our cash flows could be adversely affected.

We are dependent upon attracting residents who have sufficient resources to pay for our services. Circumstances that adversely affect the ability of our residents to pay for our services could have a material adverse effect on us.

Approximately 83% of our total revenues for the years ended December 31, 2005 and 2004 were attributable to private pay sources. We expect to continue to rely primarily on the ability of residents to pay for our services from their personal or family financial resources and long-term care insurance. Future economic or investment market conditions or other circumstances that adversely affect the ability of seniors to pay for our services could have a material adverse effect on our business, financial condition, and results of operations.

We are susceptible to risks associated with the lifecare benefits that we offer the residents of our lifecare entrance fee communities.

We operate seven lifecare entrance fee communities that offer residents a limited lifecare benefit. Residents of these communities pay an upfront entrance fee upon occupancy, of which a portion is generally refundable, with an additional monthly service fee while living in the community. This limited lifecare benefit is typically (a) a certain number of free days in the community's health center during the resident's lifetime, (b) a discounted rate for such services, or (c) a combination of the two. The lifecare benefit varies based upon the extent to which the resident's entrance fee is refundable. The pricing of entrance fees, refundability provisions, monthly service fees, and lifecare benefits are determined utilizing actuarial projections of the expected morbidity and mortality of the resident population. In the event the entrance fees and monthly service payments established for our communities are not sufficient to cover the cost of lifecare benefits granted to residents, the results of operations and financial condition of these communities could be adversely affected.

Residents of these entrance fee communities are guaranteed a living unit and nursing care at the community during their lifetime, even if the resident exhausts his or her financial resources and becomes unable to satisfy his or her obligations to the community. In addition, in the event a resident requires nursing care and there is insufficient capacity for the resident in the nursing facility at the community where the resident lives, the community must contract with a third party to provide such care. Although we screen potential residents to ensure that they have adequate assets, income, and reimbursements from government programs and third parties to pay their obligations to our communities during their lifetime, we cannot assure you that such assets, income, and reimbursements will be sufficient in all cases. If insufficient, we have rights of set-off against the refundable portions of the residents' deposits, and would also seek available reimbursement under Medicaid or other available programs. To the extent that the financial resources of some of the residents are not sufficient to pay for the cost of facilities and services provided to them, or in the event that our communities must pay third parties to provide nursing care to residents of our communities, our results of operations and financial condition would be adversely affected.

We are susceptible to risks associated with the concentration of our facilities in certain geographic areas.

Part of our business strategy is to own, lease or manage senior living communities in concentrated geographic service areas. We have a large concentration of communities in Florida, Texas, Arizona and Colorado, among other areas. Accordingly, our operating results may be adversely affected by various regional and local factors, including economic conditions, real estate market conditions, competitive conditions, hurricanes and other weather conditions and applicable laws and regulations.

We have incurred losses in recent years and have only recently been profitable.

We experienced losses from operations during the past several years, as recently as 2004. We have been profitable since the quarter ended December 31, 2004 as a result of various factors, including increased occupancy at our communities, increased revenue per unit from rate increases and additional fees and services, and reduced debt service costs. Our future earnings and cash flow from operations may be negatively impacted by various operating and market factors, many of which are beyond our control, and there can be no assurance that recent trends will continue.

We are susceptible to risks associated with government regulation of the healthcare industry and the burdens of compliance with such regulations.

Federal and state governments regulate various aspects of our business. The development and operation of senior living communities and the provision of health care services are subject to federal, state, and local licensure, certification, and inspection laws. Failure to comply with these laws and regulations could result in the denial of reimbursement, the imposition of fines, temporary suspension of admission of new patients, restrictions on operating or marketing entrance fee communities, suspension or decertification from Medicare, Medicaid, or other state or federal reimbursement programs, restrictions on our ability to acquire new communities or expand existing communities, or revocation of a community’s license. We cannot assure you that we will not be subject to penalties in the future, or that federal, state, or local governments will not impose restrictions on our activities that could materially adversely affect our business, financial condition, or results of operations.

Various states, including several of the states in which we currently operate, control the supply of licensed skilled nursing beds through certificate of need (CON) or other programs. In those states, approval is required for the construction of certain types of new health care communities, the addition of licensed beds and some capital expenditures at those communities. To the extent that a CON or other similar approval is required for the acquisition or construction of new communities or the expansion of the number of licensed beds, services, or existing communities, we could be adversely affected by our failure or inability to obtain that approval, changes in the standards applicable for that approval, and possible delays and expenses associated with obtaining that approval.

Federal and state anti-remuneration laws, such as “anti-kickback” laws, govern some financial arrangements among health care providers and others who may be in a position to refer or recommend patients to those providers. These laws prohibit, among other things, some direct and indirect payments that are intended to induce the referral of patients to, the arranging for services by, or the recommending of a particular provider of health care items or services. Federal anti-kickback laws have been broadly interpreted to apply to some contractual relationships between health care providers and sources of patient referral. Similar state laws vary, are sometimes vague, and seldom have been interpreted by courts or regulatory agencies. Violation of these laws can result in loss of licensure, substantial civil and criminal penalties and exclusion of health care providers or suppliers from participation in Medicare and Medicaid programs. There can be no assurance that those laws will be interpreted in a manner consistent with our practices.

Under the Americans with Disabilities Act of 1990, all places of public accommodation are required to meet federal requirements related to access and use by disabled persons. A number of additional federal, state and local laws exist that also may require modifications to existing and planned communities to create access to the properties by disabled persons. Although we believe that our communities are substantially in compliance with present requirements or are exempt therefrom, if required changes involve a greater expenditure than anticipated or must be made on a more accelerated basis than anticipated, additional costs would be incurred by us. Further legislation may impose additional burdens or restrictions with respect to access by disabled persons, the costs of compliance with which could be substantial.

The Health Insurance Portability and Accountability Act of 1996, or HIPAA, among other things, established standards for the use of and access to health information. Known as the administrative simplification requirements, these provisions, as implemented by regulations published by the United States Department of Health and Human Services, established among other things, standards for the security and privacy of health information. Additionally, the rules provide for the use of uniform standard codes for electronic transactions and require the use of uniform employer identification codes. Penalties for violations can range from civil fines to criminal sanctions for the most serious offenses. Compliance with the rules was phased in through April 2005. These rules are complicated, and there are still a number of unanswered questions with respect to the extent and manner in which the HIPAA rules apply to businesses such as those operated by us.

We are subject to risks associated with complying with Section 404 of the Sarbanes-Oxley Act of 2002.

We are subject to various regulatory requirements, including the Sarbanes-Oxley Act of 2002. Under Section 404 of the Sarbanes-Oxley Act of 2002, our management is required to include a report with each Annual Report on Form 10-K regarding its internal controls over financial reporting. We have implemented processes documenting and evaluating our system of internal controls. Complying with these new requirements is extremely expensive, time consuming and subject to changes in regulatory requirements. The existence of one or more material weaknesses, management's conclusion that its internal controls over financial reporting are not effective, or the inability of our auditors to express an opinion or attest that our management's report is fairly stated, could result in a loss of investor confidence in our financial reports, adversely affect our stock price and/or subject us to sanctions or investigation by regulatory authorities

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The table below sets forth certain information with respect to the senior living communities we operated at December 31, 2005.

Retirement Centers		Unit Capacity[1]					
Community	Location	IL	AL	ME	SN	Total	Commencement of Operations[2]
Owned[3]:							
Freedom Village Brandywine	West Brandywine, PA	292	16	18	47	373	Jun-00
Freedom Plaza Care Center[8]	Peoria, AZ	-	44	-	128	172	Jul-01
Homewood at Corpus Christi	Corpus Christi, TX	60	30	-	-	90	May-97
Lake Seminole Square	Seminole, FL	305	33	-	-	338	Jul-98
Galleria Woods	Birmingham, AL	154	24	-	30	208	Jan-05
Wilora Lake Lodge	Charlotte, NC	135	48	-	-	183	Dec-97
Subtotal		946	195	18	205	1,364	
Leased:							
Broadway Plaza[4]	Ft. Worth, TX	214	40	-	122	376	Apr-92
Carriage Club of Charlotte[5]	Charlotte, NC	276	56	34	42	408	May-96
Carriage Club of Jacksonville[6]	Jacksonville, FL	238	60	-	-	298	May-96
Freedom Plaza Arizona[7]	Peoria, AZ	346	-	-	128	474	Jul-98
Freedom Plaza Sun City Center[9]	Sun City Center, FL	428	26	-	108	562	Jul-98
Freedom Village Holland[9]	Holland, MI	327	21	28	67	443	Jul-98
The Hampton at Post Oak[6]	Houston, TX	148	39	-	56	243	Oct-94
Heritage Club[10]	Denver, CO	200	35	-	-	235	Feb-95
Heritage Club at Greenwood Village[11]	Denver, CO	-	75	15	90	180	Dec-00
Holley Court Terrace[12]	Oak Park, IL	161	18		-	179	Oct-01
Homewood at Victoria[13]	Victoria, TX	59	30		-	89	May-97
Imperial Plaza[14]	Richmond, VA	758	148	-	-	906	Oct-97
Oakhurst Towers[15]	Denver, CO	170	-	-	-	170	Feb-99
Parklane West[16]	San Antonio, TX	-	17	-	124	141	Jan-00
Park Regency[16]	Chandler, AZ	120	28	17	66	231	Sep-98
Richmond Place[17]	Lexington, KY	178	60	20	-	258	Apr-95
Santa Catalina Villas[4]	Tucson, AZ	158	70	15	42	285	Jun-94
Somerby at Jones Farm[18]	Huntsville, AL	136	48	-	-	184	Apr-99
Somerby at University Park[18]	Birmingham, AL	238	90	28	-	356	Apr-99
The Summit at Westlake Hills[4]	Austin, TX	149	30	-	90	269	Apr-92
Trinity Towers[16]	Corpus Christi, TX	197	62	20	75	354	Jan-90
Westlake Village [19]	Cleveland, OH	211	56	-	-	267	Oct-94
Subtotal		4,712	1,009	177	1,010	6,908	
Managed Property:							
Freedom Square[20]	Seminole, FL	362	107	76	194	739	Jul-98
Total Retirement Centers		6,020	1,311	271	1,409	9,011	

Free-standing Assisted Living Communities

Community	Location	Unit Capacity[1] IL	AL	ME	SN	Total	Commencement of Operations[2]
Owned[3]:							
Bahia Oaks Lodge	Sarasota, FL	-	92	-	-	92	Jun-98
Freedom Inn at Scottsdale	Scottsdale, AZ	-	94	26	-	120	Mar-01
Hampton at Cypress Station[23]	Houston, TX	-	80	19	-	99	Feb-99
Hampton at Willowbrook	Houston, TX	-	52	19	-	71	Jun-99
Homewood at Air Force Village	San Antonio, TX	-	39	-	-	39	Nov-00
Homewood at Castle Hills	San Antonio, TX	22	59	21	-	102	Feb-01
Homewood at Rockefeller Gardens	Cleveland, OH	37	66	34	-	137	Dec-99
Homewood at Tarpon Springs	Tarpon Springs, FL	-	64	-	-	64	Aug-97
Summit at Lakeway	Austin, TX	-	66	15	-	81	Sep-00
Summit at Northwest Hills	Austin, TX	-	106	16	-	122	Aug-00
Village of Homewood[22]	Lady Lake, FL	-	32	16	-	48	Apr-98
Subtotal		59	750	166	-	975	
Leased:							
Broadway Plaza at Pecan Park[11]	Fort Worth, TX	-	80	20	-	100	Aug-00
Broadway Plaza at Westover Hills [16]	Ft. Worth, TX	-	74	17	-	91	Feb-01
Hampton at Pearland[16]	Houston, TX	15	52	18	-	85	Feb-00
Hampton at Pinegate[16]	Houston, TX	-	81	18	-	99	May-00
Hampton at Spring Shadows[16]	Houston, TX	-	53	16	-	69	May-99
Hampton at Shadowlake[16]	Houston, TX	-	83	16	-	99	Apr-99
Heritage Club at Aurora[24]	Aurora, CO	-	80	18	-	98	Jun-99
Heritage Club at Lakewood[24]	Lakewood, CO	-	78	18	-	96	Apr-00
Homewood at Bay Pines[24]	St Petersburg, FL	-	80	-	-	80	Jul-99
Homewood at Boca Raton[11]	Boca Raton, FL	-	60	18	-	78	Oct-00
Homewood at Boynton Beach[6]	Boynton Beach, FL	-	81	18	-	99	Jan-00
Homewood at Brookmont Terrace[25]	Nashville, TN	-	62	34	-	96	May-00
Homewood at Cleveland Park[24]	Greenville, SC	-	75	17	-	92	Aug-00
Homewood at Coconut Creek[11]	Coconut Creek, FL	-	80	18	-	98	Feb-00
Homewood at Countryside[24]	Safety Harbor, FL	-	57	26	-	83	Oct-99
Homewood at Deane Hill [16]	Knoxville, TN	-	78	29	-	107	Oct-98
Homewood at Delray Beach[26]	Delray Beach, FL	-	52	32	-	84	Oct-00
Homewood at Naples[24]	Naples, FL	-	76	24	-	100	Sep-00
Homewood at Richmond Heights[6]	Cleveland, OH	-	78	17	-	95	Feb-00
Homewood at Sun City Center[9]	Sun City Center, FL	-	60	31	-	91	Aug-99
Homewood at Shavano Park[6]	San Antonio, TX	-	63	19	-	82	Jun-00
Subtotal		15	1,483	424	-	1922	

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Community	Location	Unit Capacity[1] IL	AL	ME	SN	Total	Commencement of Operations[2]
Managed with Partial Ownership through Joint Ventures:							
Freedom Inn Minnetonka[28]	Minnetonka, MN	-	90	39	-	129	Nov-05
Freedom Inn at Overland Park[28]	Overland Park, KS	-	87	14	-	101	Nov-05
Freedom Inn of Sun City West[28]	Sun City West, AZ	-	83	14	-	97	Nov-05
Freedom Inn of Roswell[28]	Roswell, GA	-	96	-	-	96	Nov-05
Freedom Inn Ventana Canyon[28]	Tucson, AZ	-	92	-	-	92	Nov-05
Hampton Assisted Living at Tanglewood[28]	Houston, TX	-	112	-	-	112	Nov-05
Heritage Club at Denver Tech Center[28]	Denver, CO	-	81	16	-	97	Nov-05
Heritage Club Las Vegas[28]	Las Vegas, NV	-	90	18	-	108	Nov-05
McLaren Homewood Village[21]	Flint, MI	-	80	35	-	115	Apr-00
Subtotal		-	811	136	-	947	
Total Free-standing Assisted Living Communities		74	3,044	726	-	3,844	

Management Services: [27]

Community	Location	Unit Capacity[1] IL	AL	ME	SN	Total	Commencement of Operations[2]
ASF Bradford Village	Edmond, OK	78	44	-	111	233	Sep-05
Burcham Hills	East Lansing, MI	84	67	34	133	318	Nov-78
Glenview at Pelican Bay	Naples, FL	118	-	-	33	151	Jul-98
Legacy Crossings	Franklin, TN	124	-	-	-	124	Feb-04
Parkplace	Denver, CO	177	43	17	-	237	Oct-94
The Towers	San Antonio, TX	353	-	-	-	353	Oct-94
Subtotal		934	154	51	277	1,416	
Grand Total		7,028	4,509	1,048	1,686	14,271	

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(1) As of December 31, 2005, unit capacity by care level and type: independent living residences (IL), assisted living residences (AL), memory enhanced or Alzheimers (ME), and skilled nursing beds (SN).

(2) Indicates the date on which we acquired each of our owned and leased communities, or commenced operating our managed communities. We have operated certain of our communities pursuant to management agreements prior to acquiring the communities.

(3) Our owned communities may be subject to mortgage liens or serve as collateral for various financing arrangements. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

(4) Leased pursuant to a master operating lease expiring September 23, 2013, with renewal options for up to two additional ten-year terms.

(5) Leased pursuant to an operating lease expiring December 31, 2016, with renewal options for up to two additional five-year terms.

(6) Leased pursuant to a master operating lease expiring March 31, 2017, with renewal options for up to two additional ten-year terms.

(7) Leased pursuant to an operating lease expiring July 2018, with renewal options for up to two additional ten-year terms.

(8) The community was owned by Maybrook Realty, Inc., of which W.E. Sheriff, our chairman, chief executive officer and president owns 50%. This lease was previously operated pursuant to an operating lease. During July 2005, we exercised our option to purchase the real assets of this community at a predetermined price.