AMERICAN RETIREMENT CORP
Form 10-K
March 09, 2004

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, 2003
Commission file number 01-13031

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

Tennessee	62-1674303
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
111 Westwood Place, Suite 200, Brentwood, TN	37027
(Address of Principal Executive Offices)	(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 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 _X_ No ___

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 the 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. ____

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ___ No _X_

The aggregate market value of common stock held by non-affiliates of the registrant as of June 30, 2003, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $39.3 million. The market value calculation was determined using a per share price of $2.10, 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).

As of March 5, 2004, 21,827,264 shares of the registrant's common stock were outstanding.

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 19, 2004 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 (collectively with its wholly-owned and majority owned subsidiaries, the "Company"), established in 1978, is one of the ten largest operators of senior living communities in the United States. The Company is 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. The Company believes it is one of the few national operators providing a range of service offerings and price levels across multiple communities. The Company currently operates 65 senior living communities in 14 states, with an aggregate unit capacity of approximately 12,900 units and resident capacity of approximately 14,500. The Company owns 19 communities, leases 41 communities, and manages five communities pursuant to management agreements.

The Company believes it is a leading operator of independent living communities, continuing care retirement communities ("CCRCs"), and free-standing assisted living communities ("Free-standing ALs"). The Company has also developed specialized care programs for residents with Alzheimer's and other forms of dementia and provides therapy services to many of its residents. The Company's operating philosophy was inspired by the vision of its 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 its residents.

Operating Segments

The Company operates in three distinct business segments: Retirement Centers, Free-standing ALs, and Management Services.

Retirement Centers - The Company operates large CCRCs and independent living communities ("Retirement Centers") that provide an array of services, including independent living, assisted living, Alzheimer's and skilled nursing care. Retirement Centers are large, often campus style or high-rise settings with an average unit capacity of approximately 300 units. These communities generally maintain high and consistent occupancy levels, many with waiting lists of prospective residents. The Company's Retirement Centers are the largest segment of the Company's business and comprise 27 of the 65 communities that the Company operates, with unit capacity of approximately 8,100, representing approximately 63% of the total unit capacity of the Company's communities. At both December 31, 2003 and 2002, the Company's Retirement Centers had an occupancy rate of 94%.

Free-standing ALs - The Company's Free-standing ALs provide specialized assisted living care to residents in a comfortable residential atmosphere. Most of the Free-standing ALs 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 the Company believes residents prefer as opposed to the more clinical or institutional settings offered by some other providers. Free-standing ALs are much smaller than Retirement Centers and have an average unit capacity of 91 units. At each of its Free-standing ALs, the Company provides personalized care plans for each resident, extensive activity programs, and access to therapy or other services as needed. Most of the Company's Free-standing ALs were developed and opened during 1999 and 2000, in response to the emergence of the assisted living segment of the senior living industry in the mid-1990s. While the assisted living segment of the industry has grown rapidly during the past decade, it has also suffered from adverse market conditions, including significant overdevelopment and overcapacity in most markets, resulting in longer than anticipated fill-up periods, price discounting and price pressures. The adverse overcapacity conditions and price pressures improved in many markets during 2003, and the Company expects these conditions to continue to improve in 2004 in many markets. The Company operates 33 Free-standing ALs, with unit capacity of approximately 3,000, representing approximately 23% of the total unit capacity of the Company's communities. Seventeen of these Free-standing ALs are still in the fill-up stage and have not yet reached stabilized occupancy levels (i.e., 90% or greater occupancy). Excluding two communities owned through non-consolidated joint ventures and three communities which are designated as held-for-sale, the 28 Free-standing ALs included in this segment had occupancy rates of 84% and 81% at December 31, 2003 and 2002, respectively.

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Management Services - The Company also operates five large Retirement Centers owned by others under multi-year management agreements ("Management Services"). Under its management agreements, the Company receives management fees as well as reimbursed expense revenues which reimburse associated expenses the Company incurs on behalf of the owners. Two of these communities are Retirement Center cooperatives that are owned by their residents, and one of these is a Retirement Center owned by a not-for-profit sponsor. A fourth Retirement Center is owned by an unaffiliated third party. The Company's remaining management agreement relates to the Freedom Square Retirement Center ("Freedom Square"), a 735-unit entrance fee Community, which the Company manages pursuant to a long-term management contract. These five communities have approximately 1,800 units, representing approximately 14% of the total unit capacity of the Company's communities.

Operating results from these segments are discussed further in Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 19 to the Company's consolidated financial statements.

Care and Services Programs

The Company provides a wide array of senior living and health care services at its 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), skilled nursing services, and therapy services. By offering a variety of services and involving the active participation of the resident, resident's family and medical consultants, the Company is able to customize its service plans to meet the specific needs and desires of each resident. As a result, the Company believes that it is 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

The Company provides independent living services to seniors who do not yet need assistance or support with the activities of daily life ("ADLs"), but who prefer the physical and psychological comfort of a residential community for seniors that offers health care and other services. Independent living services provided by the Company include daily meals and dining programs, transportation, social and recreational activities, laundry, housekeeping, security, and health care monitoring. The Company employs health care professionals to foster the wellness of its 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. The Company's residency agreements with its 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 the Company's assisted living services generally need assistance with some or all ADLs, 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.

The Company has 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 the Company include:

-- Personal Care Services - which include assistance with ADLs 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 the Company's "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.

The Company maintains programs and special "Arbors" units at most of its 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 the Company's 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 its Retirement Center campuses, the Company operates seventeen skilled nursing centers providing traditional skilled nursing care by registered nurses, licensed practical nurses, and certified nursing aides. The Company also offers 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. The Company's skilled nursing services are primarily utilized by the Company's independent and assisted living residents who occupy the skilled nursing centers at the Company's Retirement Centers on a temporary or long-term basis. However, the Company also provides 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 under the Medicare, and in some 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.

Therapy Services

The Company historically contracted with independent third parties to provide therapy services to its residents. Beginning in 2000, the Company began administering therapy services itself and greatly expanded its in-house therapy programs. The Company currently provides a range of therapy services to its independent living, assisted living, and skilled nursing residents. The therapy services provided by the Company include physical, occupational, and speech therapy services. The Company believes that by providing these in-house therapy services, it is able to maintain a consistent, high level of care to its residents, provide a closer relationship between the therapist and the resident, and provide many continuing education opportunities for residents and their families through health fairs, seminars, and other consultative interactions. In addition, programs focused on wellness and physical fitness allow residents to maintain maximum independence. These services may be reimbursed under Medicare or paid directly by residents from private pay sources and revenues are recognized as services are provided.

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Managed Communities

The Company's management agreements with third-parties have terms of three to twenty years and require the Company to provide a wide range of services. The Company may be responsible for providing all employees, and all marketing and operations services at the community. In other agreements, the Company 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, the Company receives a monthly fee for its services based either on a contractually fixed amount or a percentage of revenues or income. The Company's existing management agreements expire at various times through June 2018, but certain agreements may be canceled by the owner of the community, without cause, on three to six months' written notice.

Entrance Fee Agreements

Six of the Company's Retirement Centers (four owned, one leased and one managed) are CCRC's that provide housing and health care services through entrance fee agreements with residents (the "EF Communities"). In addition, the Company manages two other Retirement Centers utilizing entrance fees, but does not receive the economics of the entrance fee sales for these communities. Under these 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 selected, the resident's lifecare benefit election and other variables.

Under the entrance fee agreements, generally a portion of the entrance fee is refundable to the resident or the resident's estate upon termination of the entrance fee contract. The entrance fee agreements typically contain contractual 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 refundable portion of the entrance fee is reduced to a fixed minimum percentage. However, for accounting purposes, entrance fee revenues are recognized over a longer period based on actuarial projections. The non-refundable portion of the fee is recorded as deferred entrance fee income and is amortized into revenue using the straight-line method over the estimated remaining life expectancy of the resident, based upon actuarial projections. The refundable amount of the entrance fee is a long-term liability and is recorded by the Company as refundable portion of entrance fees, until termination of the agreement.

These entrance fee agreements include limited lifecare benefits 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 such services; or (c) a combination of the two. The limited lifecare benefit also varies based upon the extent to which the resident's entrance fee is refundable.

At certain of its EF Communities, the Company offers an entrance fee program that allows the resident to participate in the appreciation in the value of the resident's unit (the "Partner Plan"). Under the Partner Plan, 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 entrance fees payable under the Partner Plan are recorded by the Company as refundable entrance fees and are amortized into revenue using the straight-line method over the remaining life of the building.

The residents under all of the Company's entrance fee agreements also pay a monthly service fee, which entitles them to the use of certain amenities and certain services. As a result of paying an entrance fee upfront, the monthly fee will be less than fees at a comparable rental community. Residents may also elect to obtain additional services, which are billed on a monthly basis or as the services are provided. The Company recognizes these additional fees as revenue on a monthly basis when these services are provided.

Business Operations

Management Structure

Each of the 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 ALs 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 ALs can focus on the care of the residents and interaction with their families or other caregivers.

The Retirement Centers and Free-standing ALs report to regional operation 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.

The 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 provide 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.

The Company believes that, through its regional and home office staff, it is 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 its Free-standing ALs, the company believes that its community staff are 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, 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. The Company believes 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

The Company solicits regular feedback from its residents, their families, and its employees through various satisfaction surveys. The Company also regularly performs 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. The Company believes 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 its procedures and programs.

Senior Living Industry

The senior living industry is highly fragmented and characterized by numerous local and regional operators. The Company is 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.

The Company believes 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 that 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, the Company expects an increase in the demand for senior living services in future years.

The Company believes 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 the family for their care. Many seniors have 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 the Company expects that providers within the industry will continue to be competitive in the future. During the second half of the 1990s, a large number of assisted living units were developed across the country, including in many of the Company's markets. This additional capacity increased the time required to fill assisted living units in most markets and resulted in significant pricing pressures in those markets. The Company believes 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. The Company competes with other companies providing independent living, assisted living, skilled nursing, and other similar service and care alternatives, many of whom may have greater financial resources than the Company.

The senior living industry is highly fragmented and characterized by many local or regional operators. The Company is 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. The Company's size allows it to centralize administrative functions that give the decentralized managerial operations cost-efficient support. The Company believes it has a reputation as a leader in the industry and as a provider of high quality services.

The Company also competes with other health care businesses with respect to attracting and retaining nurses, technicians, aides, and other high quality professional and non-professional employees and managers. The market for these professionals has become very competitive, with resulting pressure on salaries and compensation levels. However, the Company believes it is able to attract and retain quality managers through its reputation, culture, organizational stability, and competitive compensation.

Business Strategy

The Company's business strategy is to provide high-quality services to seniors at affordable prices, maintain strong competitive positions in each of its markets, and to enhance the value of its communities by expanding services and improving operating results. The Company is implementing this business strategy primarily through the following steps.

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Improve Community Operating Results:

The primary areas on which the Company is focusing in order to improve its operating results are:

-- Free-standing AL occupancy gains and increased revenue per unit - The Free-standing AL segment occupancy was 84% at December 31, 2003. The Company is focusing on increasing the occupancy in these communities and completing the fill-up of several of these communities. Revenue per unit in this segment was $3,101 (per month) during the fourth quarter of 2003, an increase of 8.6% over the fourth quarter of the prior year. Subject to market and other conditions, the Company expects that revenue per unit will increase over the next year as a result of price increases, reduced price discounting, and the "mark-to-market" effect of resident turnover as residents with lower rates are replaced by those paying higher current market rates. The Company expects that further occupancy increases will not require significant incremental cost increases, and therefore will result in high incremental operating margins.

-- Increase Retirement Center margins - The Company expects to continue to improve operating results at its Retirement Centers through a combination of selling rate increases, increased revenues from ancillary services (such as therapy services), incremental occupancy increases and control of operating expenses. During 2003, the average monthly revenue per occupied unit for the Retirement Centers increased by 5.1%, driven by increased ancillary services revenue and increased revenue from new residents paying higher monthly fees. Although the Retirement Center segment had an overall occupancy rate of 94% at December 31, 2003, the Company is focusing on filling several recent expansions and increasing occupancy at selected communities (excluding the four communities with the lowest occupancy, the overall occupancy of the remaining communities is 96%). During 2003, the Retirement Centers increased revenue by 9%, expenses by 7% and operating margin by 13%.

-- <u>Maintain strong entrance fee sales</u> - The Company is focusing on maintaining strong entrance fee sales activity. When a resident of an EF Community vacates his or her independent living unit, the community re-sells the unit to a new resident. When the former resident leaves the community, he or she (or their estate) receives a refund, which is typically a percentage of the initial entrance fee that he or she paid. Consequently, the turnover of residents results in new entrance fee sales (at higher current prices) and refunds to the former residents equal to a percentage (typically 50%) of the original entrance fee. As a result, the sale of entrance fee units at current sales prices provides significant cash flows to the Company. In addition, as new residents enter the EF Communities at current market selling rates for monthly fees, the Company generates additional revenues at the same level of occupancy. The Company's six EF Communities have 3,010 total units, of which 2,066 are independent living. The current aggregate occupancy of the independent living units within the EF Communities is 95%, and the 105 independent living units available for sale at December 31, 2003 represent approximately $16.7 million of potential sales, based upon current entrance fee prices.

-- <u>Control operating expenses</u> - The Company continues to focus on managing its operating costs through active management and use of information systems. In addition, the Company will continue to focus on its overhead costs for savings opportunities in areas such as telecommunications, utilities and staffing.

-- <u>Excel at marketing and sales</u> - The Company believes that it has a strong sales and marketing effort in each of its operating segments. It will continue to focus on this area through careful recruitment, ongoing training, strong systems support, and innovative incentive rewards for its staff.

Improve Costs of Capital and Decrease Leverage:

As a result of financing obligations incurred for the Free-standing AL development program begun in the late 1990s, and the slower fill up of these new communities stemming from market overdevelopment and other adverse market conditions, the Company entered 2002 with over $370 million of current debt maturities. In order to refinance these maturities, the Company executed mortgage refinancings, a series of sale-leaseback transactions (many on assisted living properties still in fill up stage), an exchange offer for the Company's 2002 debentures, and a high interest rate mezzanine loan and related equity investment (the "2002 Refinancing Plan"). As a result of the 2002 Refinancing Plan, the Company satisfied its current debt obligations but also incurred a substantial diminution in its book equity and a significant increase in its fixed lease and debt payments as a result of its high leverage.

As a result of the 2002 Refinancing Plan, the Company incurred approximately $113 million of debt with a 19.5% interest rate (the "Mezzanine Loan") and received a related $12 million equity investment in certain of its subsidiaries. The Company completed a sale lease-back transaction in September 2003 which resulted in the repayment of approximately $52 million of the Mezzanine Loan, and also resulted in a $93 million gain on sale, $23 million of which was recognized immediately and the balance of which will be amortized into income over the ten year life of the lease. As of December 31, 2003, the outstanding balance of the Mezzanine Loan and accrued interest was approximately $78 million.

The Company will continue to explore opportunities to refinance the Mezzanine Loan (which matures September 2007) at the earliest opportunity, including any opportunity to prepay it beginning in September 2005, when full prepayment without penalty is permitted (or sooner if agreed to by the lender, which cannot be assured). The Company will also explore opportunities to reduce its overall cost of capital through refinancings of other higher interest rate debt and leases, including its 10% Series B Convertible Senior Subordinated Notes due April 1, 2008 ("the Series B Notes"). The Series B Notes are convertible into shares of the Company's common stock at a conversion price of $2.25 at the option of the holders. As of December 31, 2003, approximately $5.1 million of the Series B Notes had been converted into shares of the Company's stock. In February 2004, the Company issued a notice of partial redemption on an additional $4.5 million of the Series B Notes, and will look for opportunities to effect the conversion or redemption of additional Series B Notes as conditions permit. The Company is also continually exploring various ways to refinance its assets with lower cost mortgage capital, particularly where improving economics of selected communities would result in lower costs of capital.

Risk Management

The delivery of personal and health care services entails an inherent risk of liability, and in recent years, participants in the senior living and health care services industry have become subject to an increasing number of lawsuits, many of which involve significant defense costs and significant claims exposure. The Company recognizes this challenging environment, and has responded in recent years by allocating significant resources to quality assurance and risk management areas, including hiring and developing significant in-house expertise focusing on these areas. Since this challenging environment is expected to continue for the foreseeable future, management believes that the expertise the Company has developed may provide a competitive advantage over smaller competitors unable to devote similar efforts and resources in this area.

People

As a service oriented business with high labor requirements, the Company will continue to focus on attracting and retaining high quality personnel to ensure it is delivering high quality services in a cost effective manor. In order to be successful in its effort, the Company has dedicated in-house recruiters to find the right people, programs designed to improve retention of associates, and training programs to ensure its associates are trained to excel in their roles.

Systems

The Company has developed certain proprietary systems to provide its managers with timely access to the information necessary to manage and control pricing levels, unit inventory levels, and the turnover and retention of employees. In addition, these systems collect information regarding effectiveness of promotions, advertising and lead sources for analysis by management. The Company believes that these systems provide strategic value in managing its business.

Growth

The Company expects the results from its current portfolio will grow over the next several years through increased occupancy, rate increases and the growth of ancillary services. Additionally, the Company expects to produce growth through added capacity and additional services. Capacity additions would come through expansions at current communities (of which 11 have expansion possibilities), acquisitions of Retirement Centers or Free-standing AL's in selected markets, or development of new Retirement Centers. The Company will also continue to build ancillary services that it can offer its residents, such as therapy, medical supplies, hospice care, and telecom services.

Government Regulation

The Company is 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, fire prevention measures, environmental matters, and compliance with building and safety codes. The Company's 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 certain services. Currently, the operation of independent living and assisted living residences are subject to limited federal and state laws. However, such regulation has increased in recent years. The Company believes that such regulation will continue to increase in the future, including the evolution of the regulation of the assisted living industry.

The Company's skilled nursing centers and home health agencies are subject to Federal certification requirements in order to participate in the Medicare and Medicaid programs. Approximately 11.8%, 10.5%, and 8.5% of the Company's total revenues for the years ended December 31, 2003, 2002, and 2001, respectively, were attributable to Medicare, including Medicare-related private co-insurance, and Medicaid. These reimbursement programs are subject to extensive regulation and frequent change, which may be beneficial or detrimental to the Company. Certain per person annual limits on therapy services, which were temporarily effective beginning in September 2003 and would have had an adverse effect in the Company's therapy services business, have recently been deferred until 2005. If re-initiated, those limits could negatively affect the Company's therapy services business.

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.

The Company's EF Communities are subject to regulation by certain state departments of insurance and various state agencies, and must meet various guidelines and disclosure requirements.

Many of the Company's 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 the Company's 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. In particular, final regulations regarding privacy and standards and code sets were issued for 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 become 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 could result in civil and criminal penalties. Management does not expect costs incurred, or costs to be incurred in order to comply with HIPAA to have a material impact on the Company's operating results.

Insurance

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. As a result, the Company has significantly increased the staff and resources involved in quality assurance, compliance and risk management. The Company currently maintains property, liability and professional medical malpractice insurance policies for the Company's owned, leased and certain of its managed communities under a master insurance program. The number of insurance companies willing to provide general and professional liability insurance for the nursing and assisted living industry has declined dramatically in recent years and the premiums and deductibles associated with such insurance have risen substantially in recent years.

During 2003, the Company's general and professional liability policy premiums were lower than 2002, but deductibles were higher (retention levels range from $1,000,000 to $5,000,000). The Company currently maintains single incident and aggregate liability protection in the amount of $15.0 million. During the years ended December 31, 2003 and 2002, the Company expensed $5.5 million and $5.7 million, respectively, of general liability, and professional medical malpractice insurance premiums, claims, and costs related to multiple insurance years. Additionally, the Company has accrued amounts to cover open claims not yet settled and incurred but not reported claims as of December 31, 2003.

The Company has operated under a large deductible workers' compensation program, with excess loss coverage provided by third party carriers, since July 1995. As of December 31, 2003, the Company's coverage for workers' compensation and related programs, excluding Texas, include excess loss coverage of $350,000 per individual claim and approximately $7.25 million in the aggregate. The Company is self-insured for amounts below the excess loss coverage. As of December 31, 2003, the Company provided cash collateralized letters of credit in the aggregate amount of $6.5 million related to this program, which is reflected as assets limited as to use on the Company's balance sheet. During the years ended December 31, 2003 and 2002, the Company expensed $4.8 million and $4.4 million, respectively, of workers' compensation premiums, claims and costs related to multiple insurance years. The Company has accrued amounts to cover open claims not yet settled and incurred but not reported claims as of December 31, 2003. 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. 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.

On January 1, 2002, the Company initiated a self-insurance program for employee medical coverage. The Company maintains stop-loss insurance coverage of approximately $150,000 per employee and approximately $18.9 million for aggregate calendar 2003 claims. 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 to the Company. Subsequent changes in actual experience (including claim costs, claim frequency, and other factors) could result in additional costs to the Company. During the year ended December 31, 2003, the Company expensed $10.1 million of employee medical insurance claims and costs. The Company has accrued amounts to cover open claims not yet settled and incurred but not reported claims as of December 31, 2003.

There can be no assurance that a claim in excess of the Company's insurance coverage limits will not arise. A claim against the Company not covered by, or in excess of, the Company's coverage limits could have a material adverse effect upon the Company. Furthermore, there can be no assurance that the Company will be able to obtain liability insurance in the future or that, if such insurance is available, it will be available on acceptable terms.

Employees

The Company employs approximately 8,700 persons. As of December 31, 2003, an aggregate of approximately 75 employees at one Free-standing AL were represented by a labor union. In addition, an aggregate of approximately 70 employees at another Free-standing AL voted for a union in 2002, but to date, no contract has been signed. The Company believes that its relationship with its employees is good.

Executive Officers

The following table sets forth certain information concerning the executive officers of the Company.

Name	Age	Position
W. E. Sheriff	61	Chairman, Chief Executive Officer and President
Gregory B. Richard	50	Executive Vice President and Chief Operating Officer
Bryan D. Richardson	45	Executive Vice President - Finance and Chief Financial Of
George T. Hicks	46	Executive Vice President - Finance and Internal Audit, Se
H. Todd Kaestner	48	Executive Vice President - Corporate Development

James T. Money	54	Executive Vice President - Sales and Marketing
Terry L. Frisby	53	Senior Vice President - Human Resources/Corporate Culture
Ross C. Roadman	53	Senior Vice President - Strategic Planning and Investor R

W.E. Sheriff has served as Chairman and Chief Executive Officer of the Company and its predecessors since April 1984 and as 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 Executive Vice President and Chief Operating Officer since January 2003 and previously served as 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 Executive Vice President - Finance and Chief Financial Officer since April 2003 and previously served as 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.

George T. Hicks has served as Executive Vice President - Finance and Internal Audit, Secretary and Treasurer since September 1993. Mr. Hicks has served in various capacities for the Company's 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 Executive Vice President - Corporate Development since September 1993. Mr. Kaestner has served in various capacities for the Company's 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 Executive Vice President - Sales and Marketing since September 1993. Mr. Money has served in various capacities for the Company's predecessors since 1978, including Vice President - Development from 1985 to 1993.

Terry L. Frisby has served as 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.

Ross C. Roadman has served as 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.

Available Information

The Company's Internet web site is http://www.arclp.com. The Company makes available free of charge through its website the Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports as soon as reasonably practicable after it electronically files or furnishes such materials to the Securities and Exchange Commission. Information contained on the Company's website is not part of this report.

The Company has also adopted a code of ethics that applies to the Company's principal executive officer, principal financial officer, principal accounting officer or controller and persons performing similar functions. A copy of such code is available on the Company's website.

Item 2. Properties

The table below sets forth certain information with respect to the senior living communities currently operated by the Company.

Retirement Centers

		Unit Capacity(1)				
Community	Location	IL	AL	ME	SN	Tot
Owned(3):						
Freedom Plaza Sun City Center	Sun City Center, FL	428	26	-	108	5
Freedom Village Brandywine	Glenmore, PA	292	15	18	47	3
Freedom Village Holland	Holland, MI	330	21	29	68	4
Homewood at Corpus Christi	Corpus Christi, TX	60	30	-	-	
Lake Seminole Square	Seminole, FL	306	33	-	-	3
Richmond Place	Lexington, KY	177	54	20	-	2
Wilora Lake Lodge	Charlotte, NC	135	47	-	-	1
Subtotal		1,728	226	67	223	2,2
Leased:						
Broadway Plaza(4)	Ft. Worth, TX	214	40	-	122	3
Carriage Club of Charlotte(5)	Charlotte, NC	276	63	34	42	4
Carriage Club of Jacksonville(6)	Jacksonville, FL	238	60	-	-	2
Freedom Plaza Arizona(7)	Peoria, AZ	348	-	42	164	5
Freedom Plaza Care Center(8)	Peoria, AZ	-	44	-	128	1
The Hampton at Post Oak(6)	Houston, TX	149	39	-	56	2
Heritage Club(9)	Denver, CO	200	35	-	-	2
Heritage Club at Greenwood Village(10)	Denver, CO	-	75	15	90	1

Community	Location	IL	AL	ME	SN	Tot
Holley Court Terrace(11)	Oak Park, IL	161	18		-	1
Homewood at Victoria(12)	Victoria, TX	59	30	-	89	
Imperial Plaza(13)	Richmond, VA	758	148	-	-	9
Oakhurst Towers(14)	Denver, CO	171	-	-	-	1
Parklane West(15)	San Antonio, TX	-	17	-	124	1
Park Regency(15)	Chandler, AZ	120	26	16	66	2
Santa Catalina Villas(4)	Tucson, AZ	162	70	15	42	2
Somerby at Jones Farm(16)	Huntsville, AL	137	48	-	-	1
Somerby at University Park(16)	Birmingham, AL	238	82	28	-	3
The Summit at Westlake Hills(4)	Austin, TX	149	30	-	90	2
Trinity Towers(15)	Corpus Christi, TX	197	62	20	75	3
Westlake Village (17)	Cleveland, OH	211	53	-	-	2
Subtotal		3,788	940	170	999	5,8
Total Retirement Centers		5,516	1,166	237	1,222	8,1

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Free-standing Assisted Living

Community	Location	Unit Capacity(1) IL	AL	ME	SN	Tot
Owned(3):						
Bahia Oaks Lodge	Sarasota, FL	-	92	-	-	
Broadway Plaza at Westover Hills	Ft. Worth, TX	-	74	17	-	
Freedom Inn at Scottsdale	Scottsdale, AZ	-	94	25	-	1
Homewood at Air Force Village	San Antonio, TX	-	39	-	-	
Homewood at Castle Hills	San Antonio, TX	22	58	17	-	
Homewood at Deane Hill	Knoxville, TN	26	52	29	-	1
Homewood at Rockefeller Gardens	Cleveland, OH	37	68	34	-	1
Homewood at Sun City Center(18)	Sun City Center, FL	-	60	31	-	
Homewood at Tarpon Springs	Tarpon Springs, FL	-	64	-	-	
McLaren Homewood Village(19)	Flint, MI	14	66	38	-	1
Summit at Northwest Hills	Austin, TX	-	106	16	-	1
Village of Homewood(20)	Lady Lake, FL	-	32	15	-	
Subtotal		99	805	222	-	1,1
Leased:						
Hampton at Cypress Station(21)	Houston, TX	-	81	19	-	1
Hampton at Pearland(15)	Houston, TX	15	55	17	-	
Hampton at Pinegate(15)	Houston, TX	-	80	16	-	
Hampton at Spring Shadows(15)	Houston, TX	-	54	16	-	
Hampton at Willowbrook(15)	Houston, TX	-	54	18	-	
Hampton at Shadowlake(15)	Houston, TX	-	80	19	-	
Heritage Club at Aurora(22)	Aurora, CO	-	80	17	-	
Heritage Club at Lakewood(22)	Lakewood, CO	-	78	17	-	
Homewood at Bay Pines(22)	St Petersburg, FL	-	80	-	-	

Homewood at Boca Raton(10)	Boca Raton, FL	-	60	18	-	
Homewood at Boynton Beach(23)	Boynton Beach, FL	-	79	18	-	
Homewood at Brookmont Terrace(24)	Nashville, TN	-	62	33	-	
Homewood at Cleveland Park(22)	Greenville, SC	-	75	17	-	
Homewood at Coconut Creek(10)	Coconut Creek, FL	-	81	18	-	
Homewood at Countryside(22)	Safety Harbor, FL	-	59	25	-	
Homewood at Delray Beach(23)	Delray Beach, FL	-	52	33	-	
Homewood at Lakeway(15)	Austin, TX	-	66	15	-	
Homewood at Naples(22)	Naples, FL	-	76	24	-	1
Homewood at Pecan Park(10)	Fort Worth, TX	-	80	17	-	
Homewood at Richmond Heights(23)	Cleveland, OH	-	78	17	-	
Homewood at Shavano Park(6)	San Antonio, TX	-	62	17	-	
Subtotal		15	1,472	391	-	1,8
Total Free-standing ALs		114	2,277	613	-	3,0

Management Services: (25)

Community	Location	Unit Capacity(1) IL	AL	ME	SN	Tot
Burcham Hills	East Lansing, MI	85	52	54	133	3
Freedom Square(26)	Seminole, FL	362	103	76	194	7
Glenview at Pelican Bay	Naples, FL	118	-	-	35	1
Parkplace(27)	Denver, CO	176	43	17	-	2
The Towers	San Antonio, TX	353	-	-	-	3
Subtotal		1,094	198	147	362	1,8
Grand Total		6,724	3,641	997	1,584	12,9

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(1) Current unit capacity by care level and type: independent living residences (IL), assisted living residences (AL), memory enhanced (ME), and skilled nursing beds (SN).

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

(3) The Company's owned communities are 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 is owned by Maybrook Realty, Inc., of which W.E. Sheriff, the Company's chairman and chief executive officer owns 50%. Leased pursuant to a term of nine years and six months, expiring December 31, 2010, with a renewal option of ten years. The Company also has an option to purchase the community at a predetermined price.

(9) Leased pursuant to a master operating lease expiring June 30, 2012, which provides for certain purchase options and therefore is recorded as lease financing obligations. In addition, the lease includes renewal options for up to five additional ten-year terms.

(10) Leased pursuant to an operating lease expiring March 31, 2017, which provides for a contingent earn-out and therefore is recorded as lease financing obligations. In addition, the lease includes renewal options for up to two additional five-year terms.

(11) Leased pursuant to an operating lease expiring February 28, 2017, with renewal options for up to two additional five-year terms.

(12) Leased pursuant to an operating lease expiring July 2011, with renewal options for up to two additional ten-year terms.

(13) Leased pursuant to an operating lease expiring October 2017, with a seven-year renewal option. The Company also has an option to purchase the community at the expiration of the lease term.

(14) Leased pursuant to a 14-year operating lease expiring February 2013 from a managed entity. The Company also has an option to purchase the community at the expiration of the lease term.

(15) Leased pursuant to a master operating lease expiring June 30, 2014, with renewal options for up to four additional ten-year terms.

(16) Leased pursuant to an operating lease expiring August 25, 2018, with renewal options for up to two additional ten-year terms.

(17) During 2000, the Company sold the property and subsequently leased the property back from the buyer. Leased pursuant to a seven-year operating lease expiring December 31, 2007, with two renewal options of 13 and ten years. The sale lease-back agreement also includes a right of first refusal for the Company.

(18) Owned by a joint venture in which the Company owns a 50% interest.

(19) Owned by a joint venture in which the Company owns a 37.5% interest.

(20) Owned by a joint venture in which the Company owns a 50% interest.

(21) Leased pursuant to an operating lease expiring April 1, 2012, with renewal options for up to three additional five-year terms.

(22) Leased pursuant to a master operating lease expiring June 30, 2012, with renewal options for up to four additional ten-year terms.

(23) Leased pursuant to a master operating lease expiring March 31, 2017, which provides for certain purchase options or contingent earn-outs and therefore is recorded as lease financing obligations. In addition, the lease includes renewal options for up to two additional ten-year terms.

(24) Leased pursuant to an operating lease expiring October 31, 2017, which provides for a contingent earn-out and therefore is recorded as lease financing obligations. In addition, the lease includes renewal options for up to two additional five-year terms.

(25) Except as noted, the Company's management agreements are generally for terms of five to ten years, but may be canceled by the owner of the community, without cause, on three to six months written notice. Pursuant to the management agreements, the Company is generally responsible for providing management personnel, marketing, nursing, resident care and dietary services, accounting and data processing reports, and other services for these communities at the owner's expense and receives a monthly fee for its services based either on a contractually fixed amount or percentage of revenues or income plus reimbursement for certain expenses.

(26) Operated pursuant to a management agreement with a 20-year term, with two renewal options for additional ten-year terms, that provides for a management fee equal to all cash received by the community in excess of operating expenses, refunds of entry fees, capital expenditure reserves, debt service, and certain payments to the community's owner. The Company has an option to purchase the community at a predetermined price and guarantees the communities long-term debt.

(27) Operated pursuant to a management agreement with a ten-year term, with two renewal options for additional ten-year terms.

Item 3. Legal Proceedings

The ownership of property and provision of services related to the senior living industry entails an inherent risk of liability. Although the Company is engaged in routine litigation incidental to its business, there is no legal proceeding to which the Company is a party, which, in the opinion of management, will have a material adverse effect upon the Company's financial condition, results of operations, or liquidity. The Company and a community managed by the Company recently received a request for information from the United States Department of Justice for information relating to certain Medicare reimbursements, relating to a civil complaint filed by an individual. It is the Company's understanding that the inquiry relates to a third party that provided services at the community from 1995 until late 1999 (this community has been managed by the Company since mid-1998). The Company is currently unable to determine whether such action will be pursued by the Department of Justice or the potential outcome or liability to the Company of any such action. The Company carries liability insurance against certain types of claims that management believes meets industry standards. The Company believes that these liabilities have been adequately accrued for as of December 31, 2003. See "Business - Insurance." There can be no assurance that the Company will continue to maintain such insurance, or that any future legal proceedings (including any related judgments, settlements or costs) will not have a material adverse effect on the Company's financial condition, liquidity, or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The Company's Common Stock trades on the New York Stock Exchange under the symbol "ACR." The following table sets forth, for the periods indicated, the high and low sales prices for the Company's Common Stock as reported on the NYSE.

Year Ended December 31, 2003	High	Low
First Quarter	$3.000	$1.500
Second Quarter	2.250	1.500
Third Quarter	3.400	1.960
Fourth Quarter	3.600	2.960

Year Ended December 31, 2002	High	Low
First Quarter	$2.800	$1.000

Second Quarter	3.140	1.700
Third Quarter	2.600	1.600
Fourth Quarter	2.020	1.300

As of March 1, 2004, there were approximately 484 shareholders of record and approximately 2,227 persons or entities holding Common Stock in nominee name.

It is the current policy of the Company's Board of Directors to retain all future earnings to repay debt obligations. Accordingly, the Company does not anticipate declaring or paying cash dividends on the Common Stock in the foreseeable future. The payment of cash dividends in the future will be at the sole discretion of the Company's Board of Directors and will depend on, among other things, the Company's earnings, operations, capital requirements, financial condition, restrictions in then existing financing agreements, and other factors deemed relevant by the Board of Directors. However, certain financing agreements currently prohibit the payment of cash dividends on our common stock.

The Company did not sell any securities during the year ended December 31, 2003 without registration under the Securities Act of 1933, as amended.

Item 6. Selected Financial Data

The selected financial data presented below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and notes thereto included elsewhere in this report(1).

	Years Ended December 31,		
	2003	2002	2001
Operating and Other Data:		(in thousands, except per sha	
Communities (At end of period):			
Retirement Centers	27	26	25
Free-standing ALs	33	33	32
Managed	5	6	8
Total communities	65	65	65
Unit capacity (At end of period):			
Retirement Centers	8,141	7,800	7,246
Free-standing ALs	3,004	2,997	2,906
Managed	1,801	2,092	2,624
Total capacity	12,946	12,889	12,776
Occupancy rate (At end of period):			
Retirement Centers	94%	94%	94%
Free-standing ALs	83%	80%	63%
Managed	97%	92%	90%
Occupancy rate	92%	91%	86%

Statement of Operations Data:

Total revenues	$368,096	$328,634	$263,520	
Retirement Center revenues	279,329	255,562	224,703	
Free-standing AL revenues	78,491	66,067	29,217	
Community operating expenses	248,846	233,460	179,718	
Operating margin(2)	30%	27%	29%	
General and administrative	25,410	26,720	29,297	
Lease expense				
Operating lease expense	47,095	35,748	16,917	
Synthetic lease expense	-	35,821	18,450	
Amortization of leasehold acquisition costs				
Leasehold amortization - operating	2,421	2,094	1,272	
Leasehold amortization - synthetic	-	9,089	708	
Interest expense	50,437	46,325	38,422	
Net (loss) income	$(17,314)	$ (94,757)	$ (34,922)	$
Basic (loss) earnings per share	$ (0.95)	$ (5.48)	$ (2.03)	$
Weighted average basic shares outstanding	18,278	17,294	17,206	
Diluted (loss) earnings per share	$ (0.95)	$ (5.48)	$ (2.03)	$
Weighted average diluted shares outstanding	18,278	17,294	17,206	

	At December 31,			
	2003	2002	2001	
			(in thousands)	
Balance Sheet Data:				
Cash and cash equivalents	$16,706	$ 18,244	$ 19,334	$
Working capital (deficit)	11,199	15,725	(368,453)	
Land, buildings and equipment, net	464,888	578,804	525,174	
Total assets	715,035	839,998	850,191	
Convertible Debt	10,856	15,956	137,980	
Long-term debt, including current portion	343,839	524,695	424,145	
Refundable portion of entrance fees	62,231	59,609	46,309	
Deferred entrance fee income	122,389	118,498	51,211	
Deferred gain on sale lease-back transactions	92,596	27,622	13,055	
Shareholders' equity	807	12,907	107,548	

(1) Effective January 1, 2002, the Company changed its method of accounting for goodwill in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" and impairment of long-lived assets and discontinued operations in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets."

(2) Operating margin is calculated by subtracting Community Operating Expenses from the sum of Retirement Center and Free-standing AL revenues ("Community Revenues"), and dividing the result by the Community Revenues.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The senior living industry is experiencing growth as a result of demographic and various other factors. According to census data, the over age 75 population in the United States is growing much faster than the general population. The Company has seen increasing demand for services at both its Retirement Centers and Free-standing ALs during the past year, and expects that this demand will continue over the next several years. As a general rule, economic factors that affect seniors will have a corresponding impact on the senior living industry. For example, general concerns regarding lower interest rates on savings and uncertainty of investment returns have impacted seniors during the past several years, as well as uncertainties related to world events such as the Iraqi war. On the other hand, the continuing strength of the home resale market in most areas of the country has been beneficial to seniors, since the equity from the sale of a home is a significant source of funding for senior living care in many cases. In addition, overall economic conditions and general consumer confidence can impact the industry, since many adult children subsidize the cost for care of elderly parents, and share in decisions regarding their care.

The assisted living industry is maturing and rapidly evolving. The demand for assisted living services increased significantly beginning with the emergence of the industry segment in the mid-1990s. However, the development of new assisted living communities across the country outstripped demand during this period, resulting in oversupply of unit capacity, longer fill up times, price pressures and deep discounting. While this trend continues, the demand for assisted living services, coupled with minimal new development activity, reduced to some extent the oversupply in many of the Company's markets in 2002 and 2003. As a result, the Company was able to increase occupancy and increase rates and reduce promotional discounting for its Free-standing ALs during 2003. The Company believes that new assisted living development will remain at sustainable levels and accordingly, this trend will continue. The average length of stay in the Free-standing AL segment is approximately two years, which represents a challenge and an opportunity for the Company. The Company must find a number of new residents to maintain and build occupancy. However, it also has the opportunity to "mark-to-market" if it is able to attract new residents at higher current market rates, replacing those prior residents that had lower or discounted rates.

The Retirement Center segment is a more mature segment of the industry, and has seen demand and price increases in recent years, with new unit capacity entering the market at sustainable levels. Management expects this growth in demand and selling rate increases to continue over the next several years. The average length of stay is much longer in the Retirement Centers, approximately five years in the rental communities, and approximately 12 years in the EF Communities. In addition, the Company believes that many of its Retirement Centers benefit from significant barriers to entry from competitors, including the significant cost and length of time to develop competitive communities, the difficulty in finding acceptable development sites in the geographical areas in which the Company's Retirement Centers are located, and the length of time and difficulty in developing strong competing reputations.

The Company earns its revenues primarily by providing housing and services to its residents. Approximately 88% of its revenues come from private pay sources, meaning that residents or their families pay from their own funds (or from the proceeds of their long-term care policies). All private pay residents are billed in advance for the next month's housing and care. In addition, the Company receives revenues from the sale of entrance fee contracts at the Company's EF Communities. While this cash is received at the time the resident moves in, the non-refundable portion of the entrance fee is primarily recognized as income for financial reporting purposes over the actuarial life of the resident.

The Company's most significant expenses are:

-- Community operating expenses - Labor and labor related expenses for community associates are approximately 60% of this line item. Other significant items in this category are food costs, property taxes, utility costs, marketing costs and insurance. The Company increased its marketing expenditures in recent years in response to overcapacity in the assisted living industry, and in response to general economic conditions during 2002 and early 2003.

-- General and administrative - Labor costs are also the largest component for this category, comprising the home office and regional staff supporting the communities. Other significant items are liability insurance and related costs, travel, and legal and professional services. In response to higher liability insurance costs and deductibles in recent years, and the inherent liability risk in providing personal and health-related services to seniors, the Company has significantly increased its staff and resources involved in quality assurance, compliance and risk management.

-- Lease expense - The Company's lease expense has grown significantly over the past two years, as a result of the large number of sale-leaseback transactions completed in connection with the 2002 Refinancing Plan, as well as various 2003 transactions. The Company's lease expense includes the rent expense for all operating leases, plus an accrual for lease escalators in future years (the impact of these future escalators is spread evenly over the lease term for financial reporting purposes).

-- Depreciation and amortization expense - The Company incurs significant depreciation expense on its fixed assets (primarily community buildings and equipment) and amortization expense related primarily to leasehold acquisition costs.

-- Interest expense - The Company's interest expense is comprised of interest on its outstanding debt and capital leases. The interest expense includes both the current cash portion (9.0%) and the accrued but deferred portion (10.5%) of the 19.5% interest under the Mezzanine Loan.

Results of Operations

The Company's results of operations in recent years should be considered in light of the following factors, some of which are likely to influence the Company's future operating results and financial outlook:

-- Prior to the late 1990s, the Company exclusively owned and operated Retirement Centers.

-- The Company's expansion into the assisted living market during the late 1990s (with most of its Free-standing ALs opening during 1999 and 2000) resulted in large amounts of new debt and lease financing. While the assisted living market grew rapidly during this period, an oversupply of new units caused slower than anticipated fill up times for these communities, at lower than anticipated prices. Consequently, many of the Free-standing ALs incurred large start-up losses beginning in 2000, and have taken longer than anticipated to reach stabilized occupancy levels. Seventeen of the Free-standing ALs have not yet reached stabilized occupancy. As a result, the Company's Free-standing AL portfolio consumed the majority of the Company's available cash over the past several years.

-- The Company had over $370 million of current debt maturities during 2002, which was largely associated with the development and financing of the Free-standing ALs, which were maturing at a time when the Free-standing ALs were still filling up and producing weak operating results. In addition, the assisted living industry in general, was in a weakened financial condition and many providers were insolvent. As a result, the Company had diminished access to mortgage refinancings and other capital sources during this period.

-- The Company completed the 2002 Refinancing Plan which included mortgage refinancings, a series of sale-leaseback transactions (predominately on assisted living properties still in fill up stage), an exchange offer for its maturing convertible debentures and the Mezzanine Loan.

-- Many of these financing transactions resulted in large gains or losses to the Company. While the losses immediately reduced the Company's reported equity, approximately $93 million of gains on various sale-leaseback transactions have been deferred and will be recognized over the terms of the subject leases.

-- Although the Company satisfied its 2003 current debt maturities through the 2002 Refinancing Plan, the Company remains highly leveraged with substantial debt and lease obligations. The Company incurred additional debt and lease obligations and most of them at increased interest rates, including the 19.5% interest rate (9% paid currently) on the Mezzanine Loan.

-- The completion of the 2002 Refinancing Plan, however, allowed the Company to focus on improving operating results and taking advantage of opportunities as they arise to reduce its cost of capital and its leverage. The Retirement Centers are the Company's largest segment and provide most of the community operating contribution. This segment has experienced significant increases in revenue and community operating contribution during the past three years, which the Company expects to continue.

-- While the Free-standing AL segment produced a positive community operating contribution for 2002, and greatly increased operating contribution for 2003. The Company expects this trend to continue so long as market conditions remain stable.

Segment Results

The Company operates in three business segments: Retirement Centers, Free-standing ALs, and Management Services.

The following table presents the number, total unit capacity and total ending and average occupancy percentages of the Company's communities by operating segment at December 31, 2003, 2002 and 2001.

	Number of Communities/ Total Ending Capacity December 31, 2003	2002	2001	Ending Occupancy % / Ending Occupied Units December 31, 2003	2002	2001	Average Occupancy% / Average Occupied Units Year ended December 31, 2003	2002	2001
Retirement Centers	27	26	25	94%	94%	94%	94%	94%	94%
	8,141	7,800	7,246	7,683	7,343	6,829	7,430	7,143	6,799
Free-standing ALs	33	33	32	83%	80%	63%	81%	73%	59%
	3,004	2,997	2,906	2,483	2,395	1,831	2,434	2,171	1,060
Management Services	5	6	8	97%	92%	90%	93%	89%	83%
	1,801	2,092	2,624	1,741	1,920	2,351	1,840	2,056	3,094
Total	65	65	65	92%	91%	86%	91%	88%	85%
	12,946	12,889	12,776	11,907	11,658	11,011	11,704	11,370	10,953

The Company measures the performance of its three business segments, in part, based upon the operating contribution produced by these business segments. The Company computes operating contribution by deducting the operating expenses associated with a segment from the revenues produced by that segment. The following table sets forth certain selected financial and operating data on an operating segment basis(1) (dollars in thousands).

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	Years Ended December 31, 2003	2002	2001	2003 vs. 20 Change	
Revenues:					
Retirement Centers	$ 279,329	$ 255,562	$ 224,703	$ 23,767	9
Free-standing ALs (2)	78,491	66,067	29,217	12,424	18
Management Services	10,276	7,005	9,600	3,271	46
Total revenue	$ 368,096	$ 328,634	$ 263,520	$ 39,462	12
Retirement Centers					
Ending occupied units	7,683	7,343	6,829	340	
Ending occupancy %	94%	94%	94%	0%	
Average occupied units	7,430	7,143	6,799	287	
Average occupancy %	94%	94%	94%	0%	
Revenue per occupied unit (per month)	$ 3,133	$ 2,981	$ 2,754	$ 151	
Operating contribution per unit (per month)	1,040	955	949	85	
Resident and healthcare revenue	279,329	255,562	224,703	23,767	
Community operating expense	186,628	173,689	147,238	12,939	
Community operating contribution (3)	92,701	81,873	77,465	10,828	
Operating contribution margin (4)	33.2%	32.0%	34.5%	1.2%	

Free-standing ALs					
Ending occupied units (5)	2,201	2,122	1,792	79	
Ending occupancy % (5)	84%	81%	63%	3%	
Average occupied units (5)	2,150	1,934	904	216	
Average occupancy % (5)	82%	74%	54%	8%	
Revenue per occupied unit	$ 3,042	$ 2,847	$ 2,693	$ 196	
Operating contribution (loss) per unit (per month)	631	271	(301)	359	1
Resident and healthcare revenue	78,491	66,067	29,217	12,424	
Community operating expense	62,218	59,771	32,480	2,447	
Community operating contribution (loss) (3)	16,273	6,296	(3,263)	9,977	1
Operating contribution (loss) margin (4)	20.7%	9.5%	(11.2%)	11.2%	1
Management services operating contribution	$ 4,771	$ 1,959	$ 2,296	$ 2,812	1
Total segment operating contributions	113,745	90,128	76,498	23,617	
As a % of total revenue	30.9%	27.4%	29.0%	3.5%	
General and administrative	$ 25,410	$ 26,720	$ 29,297	$ (1,310)	
Lease expense	47,095	71,569	35,367	(24,474)	(
Depreciation and amortization	24,265	21,255	19,737	3,010	
Amortization of leasehold costs	2,421	11,183	1,980	(8,762)	(
Asset impairment	-	4,011	6,343	(4,011)	(1
Operating income (loss)	$ 14,554	$ (44,610)	$ (16,226)	$ 59,164	

(1) Selected financial and operating data does not include any inter-segment transations or alloc

(2) Freestanding AL revenues represent the Company's consolidated revenues for the period through owned or leased. The Company acquired leasehold interests of 12 Free-standing ALs during 2001 December 31, 2001. The results of these communities are reflected in the Company's income sta acquisition and therefore, do not reflect a full year of operations until 2002.

(3) Segment Operating Contribution is calculated by subtracting the segment operating expenses fr

(4) Segment Operating Contribution Margin is calculated by dividing the operating contribution of segment revenues.

(5) Excludes two Free-standing ALs owned by the Company through joint ventures. These joint ventu consolidated Free-standing AL segment results since the Company does not own a majority inter ventures are accounted for using the equity method and are included in Other income (expense) of operations. Also excludes three communities which are designated as held-for-sale. See not financial statements.

NM Not Meaningful

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Year Ended December 31, 2003 Compared with the Year Ended December 31, 2002

The highlights of the Company's 2003 results of operations are as follows:

- The Free-standing ALs increased revenue and community operating contribution, primarily as a result of a 6.9% increase in revenue per unit, as well as an increase in occupancy from 81% to 84% during the period from December 2002 to December 2003.

- The increased revenue per unit in Free-standing ALs resulted primarily from selling rate increases, reduced discounting, and turnover of units resulting in new residents paying higher current market rates. In addition, current resident agreements contain annual rate increases (typically 2% to 4%). The increased amount of ancillary services including therapy services, has also contributed to the increased revenue per unit.

- The Free-standing AL incremental increase in operating contribution as a percentage of revenue increase was 80% for 2003 versus 2002.

- While Free-standing AL results improved significantly, the Free-standing AL portfolio must continue to increase its operating contribution margin in order for the Company to service its future debt service obligations and return to profitability. The Company is focusing on increasing the Free-standing AL community operating contribution further primarily by increasing occupancy above the current 84% level, and by increasing revenue per unit through price increases, ancillary services, and turnover of units that are at lower rates. The Company believes that, absent unforeseen market or pricing pressures, occupancy increases above 84% should produce high incremental community operating contribution margins for this segment. The primary risk to improving occupancy in the Free-standing AL portfolio is development of new unit capacity or renewed price discounting by competitors in the Company's markets, which would make it more difficult to fill vacant units and which could result in lower revenue per unit.

- Retirement Center community operating contribution increased significantly over the prior year, primarily as a result of increased revenue per unit and occupancy increases. Revenues were up 9.3% in 2003 versus the prior year, community operating expenses were up 7.4%, resulting in operating margins increasing from 32.0% to 33.2%, for the Company's largest segment.

- Revenue per unit increases at the Retirement Centers are primarily a result of increases to selling rates, increased therapy and ancillary service billings, as well as annual billing rate increases to existing residents (typically 2%-4% under most resident agreements). In addition, a significant component of the average revenue per unit increase is the "mark-to-market" effect as a result of resident turnover. Since monthly rates for new residents (current market "selling rates") are generally higher than billing rates to current residents (since annual increases to billing rates are typically capped in resident agreements), turnover typically results in a significantly increased monthly fee as a unit is rented to a new resident. This mark-to-market increase is generally more significant in EF Communities due to much longer average length of stay (12 years).

- The operating contribution from the Management Services segment increased primarily as a result of improved results at Freedom Square, the Company's largest managed community.

-- In September 2003, the Company completed a refinancing transaction that resulted in the repayment of approximately 40% of the Mezzanine Loan, reducing the balance at December 31, 2003 to $77.9 million. As a result, the Company replaced a portion of the Mezzanine Loan with lower cost, longer term leases, reducing the Company's overall cost of capital and partially addressing 2007 debt maturities.

-- While the Company's 2003 income statement shows significant improvement in operating income versus the prior year, the Company continues to incur high costs related to interest and lease obligations, and incurred a net loss of $17.3 million, despite $23.2 million of gains on the sale of certain properties.

-- During the fourth quarter of 2003 the Company reported a net loss of $6.7 million, which was not affected by any significant gain on the sale of properties.

-- In order to reduce its loss and produce net income in the future, the Company is focusing primarily on reducing its debt service costs and improving results in its Free-standing AL and Retirement Center segments, while controlling its general and administrative costs. The Company must increase occupancy in its Free-standing AL segment, and increase revenue per unit through increased rates and reduced discounting, while controlling its operating costs. The Company intends to increase ancillary services and revenue per unit in its Retirement Center segment, increase occupancy at selected communities, and control its operating costs, including labor, insurance and liability related costs.

Retirement Centers

Revenue - Retirement Center revenues were $279.3 million for the year ended December 31, 2003, compared to $255.6 million for the year ended December 31, 2002, an increase of $23.8 million, or 9.3%, which was comprised of:

-- $15.1 million from increased revenue per occupied unit. This increase is made up primarily of selling rate increases and increased ancillary services provided to residents (including a $4.7 million increase in therapy services). Rate increases include the impact of increased Medicare reimbursement rates for skilled nursing and therapy, the mark-to-market effect from turnover of residents (reselling these units at higher current selling rates) and annual increases in monthly service fees from existing residents. The Company expects selling rates to new residents will continue to increase during 2004, subject to market conditions.

-- $9.0 million from increased occupancy. The year to year increase in average occupancy was 287 units. This included the partial year impact of converting two Alabama (Somerby) communities, which were previously managed, to a lease during August 2003, and the change of the Parkplace community from owned to managed during September 2003. Occupancy of the segment at December 31, 2003 was 94%. Any occupancy gains above this level should produce significant incremental operating contributions. The Company is focused on maintaining this high level of occupancy across the portfolio, and making incremental occupancy gains at three communities with recent expansions not yet filled (65 units remain unfilled at these three communities at

December 31, 2003) and at selected other communities with below average occupancy levels.

-- ($0.3) million of other net decreases, which is primarily a $1.1 million decrease from divestitures of certain home health agencies, partially offset by other increases.

Community operating expenses - Retirement Center community operating expenses were $186.6 million for the year ended December 31, 2003, compared to $173.7 million for the year ended December 31, 2002, an increase of $12.9 million, or 7.4%, which was comprised of:

-- $7.3 million of labor and related costs. This increase is primarily a result of wage rate increases for associates, as well as approximately 600 additional employees, and the additional staffing costs of approximately $1.8 million supporting the growth of the therapy services programs. The Company does not expect significant changes in staffing levels in this segment, other than to support expansions or the growth of ancillary programs such as therapy. Wage rates of associates are expected to increase each year, subject to market conditions.

-- $1.2 million of increased marketing costs. This increase is a result of expansions at three communities, and additional marketing staff and other expenditures at selected communities.

-- $1.1 million of increased utility costs, including significant increases incurred at various communities in Texas.

-- $3.3 million of other year to year cost increases. This includes increases in insurance, food, property taxes, and other property related costs.

Community operating contribution - Retirement Center operating contribution was $92.7 million for the year ended December 31, 2003, compared to $81.9 million for the year ended December 31, 2002, an increase of $10.8 million, or 13.2%.

-- The operating contribution margin increased from 32.0% in 2002, to 33.2% in 2003, an increase of 1.2%. The 2001 margin of 34.5% decreased during 2002 primarily as a result of larger increases in labor and employee benefit costs, as well as increased insurance and liability related costs.

-- The increased margin in 2003 primarily relates to continued operational improvements throughout the Retirement Centers segment resulting from increased occupancy and revenue per occupied unit (including continued growth of the therapy services program), and control of community operating expenses including labor, employee benefits and insurance related costs.

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Free-standing ALs

Revenue - Free-standing AL revenues were $78.5 million for the year ended December 31, 2003, compared to $66.1 million for the year ended December 31, 2002, an increase of $12.4 million, or 18.8%, which was comprised of:

-- $5.5 million from increased revenue per occupied unit. This increase includes the impact of price increases, reduced discounting and promotional allowances, and the mark-to-market effect from turnover of residents (reselling these units at higher current rates), and includes $1.7 million related to increased revenues from therapy services. The Company will be focused on increasing revenue per occupied unit, subject to market constraints, through price increases, as well as the mark-to-market turnover of residents with prior discounted rates, and an increase in ancillary services such as therapy.

-- $6.9 million from increased occupancy. Occupancy increased from 81% at December 31, 2002 to 84% at December 31, 2002, an increase of 3%. The Company is focused on continuing to increase the occupancy in the Free-standing AL communities, and believes that over the long-term, this segment of the industry should be able to achieve average occupancy levels at or near those achieved in the Retirement Center segment. The Company is focused on increasing its number of move-ins, increasing average length of stay, and expanding its marketing efforts and sales training in order to increase occupancy.

-- These amounts are net of the revenue and occupancy for three communities held-for-sale, which are included as a component of discontinued operations and two Free-standing ALs owned through unconsolidated joint ventures.

Community operating expenses - Free-standing AL community operating expenses were $62.2 million for the year ended December 31, 2003, compared to $59.8 million for the year ended December 31, 2002, an increase of $2.4 million or 4.1%, which was comprised of:

-- $3.0 million of labor and labor related costs. This increase is primarily a result of wage rate increases for associates and additional staffing costs of approximately $1.0 million supporting the growth of the therapy services programs. The Company does not expect significant increases in staffing levels in this segment if occupancy levels increase over the current 84%, since most communities are nearly fully staffed at current occupancy levels and accordingly, additional occupancies will not result in a significant staffing need for the Company. However, growth of ancillary revenue programs such as therapy may require additional staff to support incremental activity. Higher recruiting and retention costs of qualified personnel increase expectations that of increased wage rates each year, subject to labor market conditions.

-- $0.6 million of food costs, primarily as a result of increased occupancy. Food costs will continue to increase in relation to occupancy.

-- ($1.2) million of other net cost decreases. This includes decreased marketing expenses (as certain communities reach stabilized occupancy levels), and various other cost decreases.

Community operating contribution - Free-standing AL operating contribution was $16.3 million for the year ended December 31, 2003, compared to $6.3 million for the year ended December 31, 2002, an increase of $10.0 million, or 159%.

-- The operating contribution margin increased from 9.5% in 2002, to 20.7% in 2003, an increase of 11.2%.

-- The increased margin in 2003 primarily relates to strong increases in revenue per occupied unit and some occupancy increases, coupled with control of community operating expenses. The incremental increase in operating contribution as a percentage of revenue increase was 80% for 2003 versus 2002.

-- The Company believes that, absent unforeseen cost pressures, revenue increases resulting from occupancy increases should produce high incremental community operating contribution margins (as a percentage of sales increase) for this segment.

Management Services Management services revenues and operating contribution were $4.8 million for the year ended December 31, 2003, compared to $2.0 million for the year ended December 31, 2002, an increase of $2.8 million, or 144%. The increase is primarily related to improved operating results at Freedom Square, a managed community in Florida.

General and Administrative. General and administrative expense was $25.4 million for the year ended December 31, 2003, compared to $26.7 million for the year ended December 31, 2002, a decrease of $1.3 million, or 4.9%.

-- This decrease is related to lower consulting and legal costs versus costs incurred during 2002 related to consummation of the transactions comprising the 2002 Refinancing Plan, offset by higher administrative costs resulting from expanded compliance and regulatory requirements.

-- The Company's accruals for costs under its self-insured medical plan was reduced in 2003 versus 2002, which was partially offset by increased accruals for liability and workers compensation claims.

-- General and administrative expense as a percentage of total consolidated revenues decreased to 6.9% for 2003 from 8.1% for 2002, a decrease of 1.2%.

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-- The Company believes that measuring general and administrative expense as a percentage of total consolidated revenues and combined revenues (including unconsolidated managed revenues) provides insight as to the level of the Company's overhead in relation to its total operating activities (including those that relate to management services). General and administrative expense as a percentage of total combined revenues decreased to 5.7% from 6.5% for the year ended December 31, 2003 and 2002, respectively, calculated as follows:

	Year ended December 31,	
	2003	2002
Total consolidated revenues	$ 368,096	$ 328,634
Revenues of unconsolidated managed communities	80,970	85,253
Less management fees	(4,771)	(1,959)
Total combined revenue	$ 444,295	$ 411,928
Total general and administrative expense	$ 25,410	$ 26,720

General and administrative expense as a %

of total consolidated revenues	6.9%	8.1%
General and administrative expense as a % of total combined revenue	5.7%	6.5%

Lease Expense. Lease expense was $47.1 million for the year ended December 31, 2003, compared to $71.6 million for the year ended December 31, 2002, a decrease of $24.5 million or 34%.

-- This decrease was primarily attributable to the additional lease expense of $30.8 million recorded during the year ended December 31, 2002, related to residual value guarantees for the termination of certain synthetic leases on various communities. As of December 31, 2002, the Company no longer operated any of its communities under synthetic lease structures.

-- Excluding the synthetic lease expense, lease expense increased $6.3 million as a result of certain sale-leaseback transactions completed in 2003 and 2002.

-- As a result of the sale-leaseback transactions completed in September 2003, three additional Retirement Centers are now leased (versus owned) properties.

-- Net lease expense for the fourth quarter of 2003 was $14.9 million, which includes current lease payments of $16.2 million, plus accruals for future lease escalators of $1.2 million, net of the amortization of the deferred gain from prior sale-leasebacks of $2.5 million.

-- Absent any additional refinancing or transactional activity, net lease expense is expected to continue during the upcoming year at a level similar to the fourth quarter of 2003 ($14.9 million).

-- As of December 31, 2003, the Company had operating leases for 32 of its communities, including 18 Retirement Centers and 14 Free-standing ALs.

Depreciation and