

**Fellowship Senior Living, Inc.**

Financial Statements

December 31, 2017 and 2016



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# **Fellowship Senior Living, Inc.**

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## **Independent Auditors' Report**

Board of Directors  
Fellowship Senior Living, Inc.

We have audited the accompanying financial statements of Fellowship Senior Living, Inc. ("FSL"), which comprise the balance sheet as of December 31, 2017 and 2016, and the related statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fellowship Senior Living, Inc. as of December 31, 2017 and 2016, and the results of its operations, changes in its net assets, and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

*Baker Tilly Virchow Krause, LLP*

Iselin, New Jersey  
April 26, 2018

**Fellowship Senior Living, Inc.**

Balance Sheet

December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 4,268,507	\$ 3,051,577
Investments	38,548,919	38,884,286
Assets whose use is limited, current portion	10,208,723	7,434,023
Accounts receivable, net of allowance for doubtful accounts of \$116,815 in 2017 and \$125,773 in 2016	2,662,402	2,896,208
Supplies and other current assets	1,199,353	980,713
Total current assets	56,887,904	53,246,807
<b>Noncurrent Assets Whose Use is Limited</b>	6,057,441	6,002,741
<b>Property and Equipment, Net</b>	68,635,433	63,990,629
<b>Long-Term Deposits</b>	80,929	111,166
Total assets	<u>\$ 131,661,707</u>	<u>\$ 123,351,343</u>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued expenses	\$ 3,639,386	\$ 2,746,137
Accrued interest payable	357,762	372,487
Current portion of long-term debt	3,894,569	3,703,904
Total current liabilities	7,891,717	6,822,528
Refundable waiting list deposits	272,481	263,480
Refundable advance fees	16,676,471	16,696,454
Deferred revenue from advance fees	19,617,605	19,775,212
Deferred revenue from forward delivery agreements	877,856	1,003,264
Deferred revenue from renovations	150,000	216,666
Long-term debt, net	44,048,525	43,147,510
Derivative instrument	5,024,999	5,135,496
Total liabilities	94,559,654	93,060,610
<b>Net Assets</b>		
Unrestricted	35,141,459	28,653,233
Temporarily restricted net assets	1,960,594	1,637,500
Total net assets	37,102,053	30,290,733
Total liabilities and net assets	<u>\$ 131,661,707</u>	<u>\$ 123,351,343</u>

See notes to financial statements

**Fellowship Senior Living, Inc.**Statement of Operations and Changes in Net Assets  
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>Unrestricted Net Assets</b>		
Revenue:		
Resident services, including amortization of advance fees of \$8,022,402 in 2017 and \$7,597,313 in 2016	\$ 26,527,125	\$ 26,568,004
Patient revenue from nonresidents	5,291,956	5,392,849
Home community based services, including amortization of advance fees of \$155,591 in 2017 and \$186,856 in 2016	5,112,103	5,277,512
Investment income and other revenue	5,835,616	5,085,643
	<u>42,766,800</u>	<u>42,324,008</u>
Total revenue		
Expenses:		
Salaries and benefits	18,647,569	18,559,984
Contracted services	5,204,536	4,850,948
Supplies and other	7,384,900	7,335,390
Interest and amortization, net	914,442	1,247,192
Depreciation	4,344,078	4,560,219
Provision for bad debt	97,713	97,632
	<u>36,593,238</u>	<u>36,651,365</u>
Total expenses		
Income from operations before accelerated depreciation	6,173,562	5,672,643
Accelerated depreciation	1,691,433	-
	<u>4,482,129</u>	<u>5,672,643</u>
Income from operations		
Early extinguishment of debt	-	(4,209,221)
Loss on disposal of property and equipment	(306,619)	(379,039)
Net change in unrealized gain on investments	2,202,219	1,664,197
Net change in fair value of derivative instrument	110,497	299,724
	<u>6,488,226</u>	<u>3,048,304</u>
Excess of revenue over expenses		
Increase in unrestricted net assets	<u>6,488,226</u>	<u>3,048,304</u>
Temporarily restricted net assets:		
Gross contributions	279,293	305,775
Net assets released from restriction	(114,769)	(127,598)
Interest income	77,440	45,646
Net change in unrealized gain on investments	81,130	110,444
	<u>323,094</u>	<u>334,267</u>
Increase in temporarily restricted net assets		
Increase in net assets	6,811,320	3,382,571
<b>Net Assets, Beginning of Year</b>	<u>30,290,733</u>	<u>26,908,162</u>
<b>Net Assets, End of Year</b>	<u>\$ 37,102,053</u>	<u>\$ 30,290,733</u>

See notes to financial statements

**Fellowship Senior Living, Inc.**

## Statement of Cash Flows

Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>Cash Flows from Operating Activities</b>		
Increase in net assets	\$ 6,811,320	\$ 3,382,571
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Cash received from advance fees and waiting list deposits, net	8,009,404	5,986,615
Amortization of advance fees	(8,177,993)	(7,784,169)
Amortization of deferred revenue from renovations	(66,666)	(66,667)
Amortization of swap termination fees	(285,014)	(76,459)
Amortization of deferred financing costs	147,798	94,992
Loss on disposal of property and equipment	306,619	379,039
Contributions restricted for capital projects	(212,302)	(159,974)
Amortization of forward delivery agreements	(125,408)	(125,408)
Depreciation	6,035,511	4,560,219
Net change in unrealized gain on investments	(2,283,349)	(1,774,641)
Net change in fair value of derivative instrument	(110,497)	(299,724)
Changes in operating assets and liabilities:		
Accounts receivable	233,806	(735,410)
Supplies and other current assets	(218,640)	(78,931)
Other long-term assets	30,237	19,797
Accounts payable and accrued expenses	893,249	(74,926)
Accrued interest payable	(14,725)	(164,388)
Net cash provided by operating activities	<u>10,973,350</u>	<u>3,082,536</u>
<b>Cash Flows from Investing Activities</b>		
Net (purchases) sales of investments and assets whose use is limited	(210,684)	1,138,100
Acquisition of property and equipment	<u>(10,986,934)</u>	<u>(4,577,720)</u>
Net cash used in investing activities	<u>(11,197,618)</u>	<u>(3,439,620)</u>
<b>Cash Flows from Financing Activities</b>		
Payment of deferred financing costs	(29,092)	(211,605)
Proceeds from issuance of long-term debt	4,018,376	50,000
Contributions restricted for capital projects	212,302	159,974
Principal payments of long-term debt	(3,418,890)	(3,922,114)
Construction retainage payable	658,502	-
Loss on early extinguishment of debt	-	4,209,221
Net cash provided by financing activities	<u>1,441,198</u>	<u>285,476</u>
Net increase (decrease) in cash and cash equivalents	1,216,930	(71,608)
<b>Cash and Cash Equivalents, Beginning</b>	<u>3,051,577</u>	<u>3,123,185</u>
<b>Cash and Cash Equivalents, Ending</b>	<u>\$ 4,268,507</u>	<u>\$ 3,051,577</u>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid for interest	<u>\$ 1,400,822</u>	<u>\$ 2,089,063</u>

See notes to financial statements

# **Fellowship Senior Living, Inc.**

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Notes to Financial Statements  
December 31, 2017 and 2016

## **1. Organization and Summary of Significant Accounting Policies**

Fellowship Senior Living, Inc. ("FSL") is a tax-exempt, not-for-profit organization, which operates a continuing care retirement community in Liberty Corner, New Jersey, consisting of 257 residential homes, a community building, and a health center consisting of 54 long-term care beds, 67 assisted living beds, 14 memory care beds, rehabilitation and wellness center, and a medical center. FSL commenced operations on May 1, 1996.

### **Use of Estimates**

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

### **Cash Equivalents**

FSL considers all highly liquid investments with a maturity of three month or less when purchased, other than those held in the investment portfolio and assets whose use is limited, to be cash equivalents. The carrying amount of cash and cash equivalents reported in the balance sheets approximates fair value.

### **Accounts Receivable**

Accounts receivable include receivables for residential and health care services. The amount of the allowance for doubtful accounts is based on historical and expected collections, business economic conditions, trends in health care coverage and other collection indicators. Net accounts receivable represents the balance of future collections.

### **Investments and Assets Whose Use is Limited**

Assets whose use is limited include assets held by trustees under bond indenture agreements; waiting list and entrance fee deposits held in escrow and assets temporarily restricted by donors.

Marketable securities included within investments and assets whose use is limited are recorded at fair value. The fair value of these investments is determined by reference to quoted market prices.

## **Fellowship Senior Living, Inc.**

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Notes to Financial Statements  
December 31, 2017 and 2016

Alternative investments consist of investments in marketable hedging instruments and limited partnership interests. The marketable hedging instruments are recorded at fair value. The fair value of these investments is determined by reference to quoted market prices. The limited partnership interest investments are reported in the accompanying balance sheets based upon net asset values derived from the application of the equity method of accounting. Generally, net asset value reflects net contributions to the investee and an ownership share of realized and unrealized investment income and expenses. Individual investment holdings of the limited partnerships may, in turn, include investments in both nonmarketable and market-traded securities. Valuations of the non-marketable securities are determined by the investment manager or general partner. These values may be based on historical cost, appraisals or other estimates that require varying degrees of judgment. The investments may indirectly expose FSL to securities lending, short sales of securities, and trading in futures and forward contracts, options and other derivative products. FSL's risk is limited to its carrying value of the limited partnerships. Such investments are subject to notification periods to divest ranging from 1 to 30 days. The financial statements of the investees are audited annually by independent auditors, although the timing for reporting the results of such audits does not coincide with FSL's annual financial statement reporting.

Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in excess of revenue over expenses unless the income is restricted by donor or law.

### **Supplies**

Supplies are carried at the lower of cost or market determined on the first-in, first-out basis.

### **Property and Equipment**

Property and equipment are stated at cost. Depreciation and amortization is computed on the straight-line method based on the estimated useful lives of the assets (ranging from 3 to 39.5 years), or the term of the related lease.

### **Deferred Costs**

Deferred financing costs are costs incurred to obtain financing. Deferred financing costs are amortized using the effective interest method over the terms of the indebtedness.

### **Refundable Advance Fees**

Refundable advance fees consist of deposits received from prospective residents who have entered into a Residency and Care Agreement. Advance fees received prior to occupancy (generally 10% of the total advance fee) are accounted for as partially refundable deposits in accordance with the terms of the Residency and Care Agreement. These deposit amounts are held in escrow and interest earned is deducted from the remaining advance fee payment (generally 90% of the total advance fee) which is payable upon occupancy.

## **Fellowship Senior Living, Inc.**

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Notes to Financial Statements  
December 31, 2017 and 2016

The advance fee deposits are refundable to the residents upon termination of the residence agreement and prior to establishing residency. After residency is established and after a 90 day probationary period, the fees are refundable to the residents on a declining balance basis according to the terms of the specific contract.

### **Deferred Revenue from Advance Fees**

Fees paid by a resident upon entering into a continuing care contract, net of the portion that is refundable to the resident, are recorded as deferred revenue and are amortized to income using the straight-line method over the estimated remaining life expectancy of the resident.

### **Obligation to Provide Future Services**

FSL calculates bi-annually the present value (using a discount rate of 5.0%) of the net cost of future services and the use of facilities to be provided to current residents and compares that amount with the balance of deferred revenue from advance fees. At December 31, 2017 and 2016 deferred revenue from advance fees exceeded the present value of the net cost of future services as determined. Therefore, an additional liability for an obligation to provide future services and use of facilities was not required.

### **Deferred Revenue from Renovations**

Deferred revenue from renovations relates to \$650,000 received to renovate FSL's dining facilities (see Note 5). The deferred revenue is amortized into revenue over a ten-year period ending March 2020 using the straight-line method.

### **Derivative Instrument**

FSL entered into interest-rate swap agreements, which are considered a derivative financial instrument to manage its interest rate risk on its long-term debt. The objective of the swap agreements was to minimize the risks associated with financing activities by reducing the impact of changes in the interest rates on variable rate debt. The swap agreements are a contract to exchange variable rate for fixed rate payments over the term of the swap agreements without the exchange of the underlying notional amount. The notional amount of the swap agreements are used to measure the interest to be paid or received and does not represent the amount of exposure to credit loss. Exposure to credit loss is limited to the receivable amount, if any, which may be generated as a result of the swap agreements. Management believes that losses related to credit risk are remote and that the swaps are continuing to function as intended.

Four (4) new derivative instruments were established on December 16, 2016, replacing the terminated derivative instruments: Two (2) for Series 2013A represented refinancing of new proceeds to be used for construction and two (2) for Series 2013B represented the refinancing of existing debt.

## Fellowship Senior Living, Inc.

Notes to Financial Statements  
December 31, 2017 and 2016

The net cash paid or received under the swap agreements is recognized as an adjustment to unrestricted net assets. FSL does not utilize the interest rate swap agreement or other financial instruments for trading or other speculative purposes.

<u>Amount</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Period</u>
As of December 31, 2017 and 2016:			
<b>Series 2013A Bonds</b>			
\$45,000,000	3.99% and 3.945%	LIBOR x 65% plus 120 basis points	October 2017 to December 2026
<b>Series 2013B Bonds</b>			
\$51,500,000	3.385% and 3.393%	LIBOR x 65% plus 120 basis points	October 2016 to December 2026

FSL recognizes the derivative instrument as either an asset or liability at fair value within the accompanying balance sheet. FSL has not designated the interest rate swap agreement as a hedging instrument and, accordingly, has recorded the net change in the fair value of the derivative instrument within the excess of revenue over expenses in the accompanying statements of operations and changes in net assets. The fair value of the agreements was a liability of \$5,024,999 and \$5,135,496 at December 31, 2017 and December 31 2016, respectively.

### Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations and changes in net assets as net assets released from restrictions.

### Pledges

FSL records unconditional pledges at fair value at the time the promise is received. Pledges to be received after one year are discounted using the U.S. Treasury rate for the applicable period. As of December 31, 2017 and 2016, pledges receivable of \$132,846 and \$51,600, respectively, are fully reserved.

### Temporarily Restricted Net Assets

FSL separately accounts for and reports donor restricted and unrestricted net assets. Temporarily restricted net assets are those whose use is limited by the donor for a specific purpose or time period. Resources arising from the results of operations or assets set aside by the Board of Trustees are not considered to be donor restricted.

## **Fellowship Senior Living, Inc.**

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Notes to Financial Statements  
December 31, 2017 and 2016

### **Revenue**

Resident services revenue is derived from residential and health care services provided to residents under Residency and Care Agreements. Patient revenue from nonresidents is derived from health care services provided to patients who have not entered into Residency and Care Agreements. In relation to revenue for certain health care services FSL has agreements with third-party payors that provide for payments at amounts different from their established rates. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement, negotiated discounts from established rates, and per diem payments.

Residential and health care services revenue is reported at the estimated net realizable amounts from residents, patients, third-party payors, and others for services rendered and includes, when applicable, estimated retroactive adjustments due to future and ongoing audits, reviews, and investigations. Residential and health care services revenue is accounted for on the accrual basis of accounting in the period in which the service is provided. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

Home community based services revenue is comprised of three types of community based services: Fellowship Freedom Plans, Fellowship Helping Hands, and Fellowship Garden State Hospice. Fellowship Freedom Plans is offered to seniors living in their own home in counties of Somerset, Hunterdon, and Middlesex in New Jersey and all areas of New Jersey north of said counties. Fellowship Helping Hands and Fellowship Garden State Hospice are fee-for-service programs for the Fellowship Village community and the outside broader community.

### **Performance Indicator**

The statements of operations and changes in net assets include the excess of revenue over expenses as the performance indicator.

Transactions deemed by management to be ongoing, major or central to the provision of residential and health care services are reported within income from operations.

### **Advertising**

Advertising costs are expensed when incurred except for direct response advertising. Direct response advertising is capitalized as a component of costs of acquiring initial continuing care contracts. FSL incurred and expensed approximately \$322,683 and \$401,057 of advertising costs for the twelve months ended December 31, 2017 and 2016, respectively.

### **General and Professional Liability**

FSL maintains claims made based professional and general liability coverage through a commercial insurance carrier.

## **Fellowship Senior Living, Inc.**

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Notes to Financial Statements  
December 31, 2017 and 2016

### **Income Taxes**

FSL is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on its exempt income under Section 501(a) of the Internal Revenue Code. FSL is also exempt from state and local income taxes under similar statutes.

FSL accounts for uncertainty in income taxes using a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold is met.

### **New Accounting Pronouncements**

#### **Fair Value Measurement**

In May 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. ASU 2015-07 removes the requirement to include investments in the fair value hierarchy for which fair value is measured using the net asset value per share practical expedient under Accounting Standards Codification 820. ASU 2015-07 is effective for years beginning after December 15, 2016 with early adoption permitted. FSL has adopted ASU 2015-17 on January 1, 2017, and was retroactively applied.

#### **Revenue Recognition**

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 supersedes the revenue recognition requirements in *Topic 605, Revenue Recognition*, and most industry-specific guidance. Under the requirements of ASU 2014-09, the core principle is that entities should recognize revenue to depict the transfer of promised goods or services to customers (residents) in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. FSL will be required to retrospectively adopt the guidance in ASU 2014-09 for years beginning after December 15, 2018; early application is not permitted. FSL has not yet determined the impact of adoption of ASU 2014-09 on its financial statements.

#### **Presentation of Financial Statements**

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new guidance is intended to improve and simplify the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. ASU 2016-14 is to be applied retroactively with transition provisions. FSL is assessing the impact this standard will have on its financial statements.

## Fellowship Senior Living, Inc.

Notes to Financial Statements  
December 31, 2017 and 2016

### Subsequent Events

FSL evaluated subsequent events for recognition or disclosure through April 26, 2018, the date the financial statements were issued.

### 2. Medicare Reimbursement System

FSL provides care to patients under Medicare. Revenue from the Medicare program accounted for approximately 9% of the revenue for twelve months ended December 31, 2017 and 2016. Future changes in the Medicare program and any reduction of funding could have an adverse impact on Fellowship Senior Living. Laws and regulations governing the Medicare program are extremely complex and subject to interpretation for which action for noncompliance includes fines, penalties and exclusion from the Medicare program. Fellowship Senior Living believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare program.

### 3. Investments and Assets Whose Use is Limited

Investments consist of the following at December 31:

	<u>2017</u>	<u>2016</u>
Cash and money market funds	\$ 554,082	\$ 1,114,295
Equities	27,580,198	23,614,709
Fixed income	8,488,485	10,331,539
Alternative investments	1,839,785	3,526,678
Other	6,500	214,599
Accrued interest	79,869	82,466
Total	<u>\$ 38,548,919</u>	<u>\$ 38,884,286</u>

Above investments, at cost, are \$37,972,846 and \$39,368,542 at December 31, 2017 and December 31, 2016, respectively.

## Fellowship Senior Living, Inc.

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December 31, 2017 and 2016

Assets whose use is limited consist of the following:

	<u>2017</u>	<u>2016</u>
Bond indenture agreements - held by trustees:		
Cash and cash equivalents	\$ 12,513,930	\$ 11,364,322
U.S. Government obligations	1,378,000	-
Total	<u>13,891,930</u>	<u>11,364,322</u>
Waiting list and entrance fee deposits:		
Cash and cash equivalents	110,562	162,055
Equities	234,014	174,832
Fixed income	68,232	77,702
Other	-	19,243
Accrued interest	832	1,110
Total	<u>413,640</u>	<u>434,942</u>
Temporarily restricted by donor:		
Cash and cash equivalents	73,548	40,925
Equities	1,199,106	796,939
Fixed income	600,167	615,508
Other	81,482	176,377
Accrued interest	6,291	7,751
Total	<u>1,960,594</u>	<u>1,637,500</u>
Total assets whose use is limited	16,266,164	13,436,764
Less assets whose use is limited, current portion	<u>10,208,723</u>	<u>7,434,023</u>
Noncurrent assets whose use is limited	<u>\$ 6,057,441</u>	<u>\$ 6,002,741</u>

These investments, excluding temporarily restricted by donor, at cost aggregated are \$14,278,854 and \$11,790,554 at December 31, 2017 and December 31, 2016, respectively.

## Fellowship Senior Living, Inc.

Notes to Financial Statements  
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Assets held by trustees under bond indenture agreements, are maintained for the following purposes at December 31:

	<u>2017</u>	<u>2016</u>
Debt service reserve funds	\$ 3,547,743	\$ 3,547,743
Debt service funds for principal and interest	4,900,519	5,173,512
Debt service Construction Fund	<u>5,443,668</u>	<u>2,643,067</u>
Total	<u>\$ 13,891,930</u>	<u>\$ 11,364,322</u>

Investment income included in investment income and other revenue consists of the following for the twelve months ending December 31:

	<u>2017</u>	<u>2016</u>
Interest and dividend income	\$ 1,630,644	\$ 1,379,310
Net realized gain	<u>473,580</u>	<u>209,478</u>
Total	<u>\$ 2,104,224</u>	<u>\$ 1,588,788</u>

During 2001, FSL entered into two Forward Delivery Agreements (the "Agreements") with a bank. In accordance with the terms of the Agreements, Fellowship Senior Living received approximately \$3,166,000 in exchange for the future income earnings on the Series 1998A, 1998B and 1998C debt service funds and the Series 1998A debt service reserve funds.

The funds received under the Agreements were recorded as deferred revenue and are amortized to income using the straight-line method over the term of the Agreements. The Agreements were scheduled to expire on January 1, 2025 and January 1, 2028 for the Series 1998A and 1998C funds respectively. The agreement for the Series 1998B funds expired on January 1, 2004. During 2008, in connection with the issuance of the Series 2008 Bonds, FSL amended the Agreements to apply them to the Series 2008 Bonds that were used to refund the Series 1998A and 1998C Bonds. The revised Agreement expires on January 1, 2025. The agreement was then amended again for the 2013 Bonds, which were issued to refund the 2008 bonds and acquire additional debt. For the twelve months ended December 31, 2017 and 2016, FSL has recorded \$125,408 and \$125,408, respectively, related to the amortization of the funds received, which is included in other revenue. At December 31, 2017 and December 31, 2016, FSL has recorded deferred revenue of approximately \$878,000 and \$1,003,000 respectively, related to the agreements.

## **Fellowship Senior Living, Inc.**

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Notes to Financial Statements  
December 31, 2017 and 2016

### **4. Fair Value Measurements**

FSL measures its investments, assets whose use is limited, and derivative financial instruments at fair value on a recurring basis in accordance with accounting principles generally accepted in the United States of America.

Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that the authoritative guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets that are accessible to FSL for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 - Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 - Fair value would be based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

## Fellowship Senior Living, Inc.

### Notes to Financial Statements December 31, 2017 and 2016

The following tables present the financial instruments carried at fair value as of December 31, 2017 by caption on the balance sheets and within the valuation hierarchy levels defined above:

Assets at Fair Value as of December 31, 2017						
	Carrying Value	Fair Value	Level 1	Level 2	Level 3	Total
<b>Reported at Fair Value</b>						
Unrestricted assets:						
Investments:						
Cash and money balances	\$ 554,082	\$ 554,082	\$ 554,082	\$ -	\$ -	\$ 554,082
Equities:						
Common stock	13,109,631	13,109,631	13,109,631	-	-	13,109,631
Structured products	5,962,327	5,962,327	5,962,327	-	-	5,962,327
Closed end funds and exchange traded products	5,290,378	5,290,378	5,290,378	-	-	5,290,378
Mutual funds	2,247,925	2,247,925	2,247,925	-	-	2,247,925
Other equity investments	120,512	120,512	120,512	-	-	120,512
Unit investment trusts	849,425	849,425	849,425	-	-	849,425
Total equities	27,580,198	27,580,198	27,580,198	-	-	27,580,198
Fixed income:						
Corporate bonds and notes	5,901,290	5,901,290	-	5,901,290	-	5,901,290
Certificates of deposit	148,037	148,037	148,037	-	-	148,037
Municipal securities	208,400	208,400	-	208,400	-	208,400
Closed end funds and exchange traded products	669,873	669,873	669,873	-	-	669,873
Mutual funds	1,556,885	1,556,885	1,556,885	-	-	1,556,885
Structured products	4,000	4,000	-	4,000	-	4,000
Total accrued interest	79,869	79,869	-	79,869	-	79,869
Total fixed income	8,568,354	8,568,354	2,374,795	6,193,559	-	8,568,354
Non-traditional:						
Mutual funds	786,675	786,675	786,675	-	-	786,675
Hedge funds	38,788	38,788	-	38,788	-	38,788
Other investments	41,500	41,500	-	41,500	-	41,500
Total non-traditional	866,963	866,963	786,675	80,288	-	866,963
Total unrestricted investments in the fair value hierarchy	\$ 37,569,597	\$ 37,569,597	\$ 31,295,750	\$ 6,273,847	\$ -	37,569,597
Investments measured at net asset value (a)						979,322
Investments at fair value						\$ 38,548,919

(a) In accordance with Subtopic 820-10, certain investments that were measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value is presented to reconcile to total investments.

# Fellowship Senior Living, Inc.

## Notes to Financial Statements December 31, 2017 and 2016

### Assets at Fair Value as of December 31, 2017

	Carrying Value	Fair Value	Level 1	Level 2	Level 3	Total
Assets whose use is limited:						
Cash and money balances	\$ 12,698,040	\$ 12,698,040	\$ 12,698,040	\$ -	\$ -	\$ 12,698,040
Equities:						
Common stock	440,457	440,457	440,457	-	-	440,457
Structured products	134,950	134,950	134,950	-	-	134,950
Closed end funds and exchange traded products	636,472	636,472	636,472	-	-	636,472
Mutual funds	173,490	173,490	173,490	-	-	173,490
Other equity investments	20,545	20,545	20,545	-	-	20,545
Unit investment trusts	27,206	27,206	27,206	-	-	27,206
Total equities	1,433,120	1,433,120	1,433,120	-	-	1,433,120
Fixed income:						
Corporate bonds and notes	401,796	401,796	-	401,796	-	401,796
Closed end funds and exchange traded products	120,904	120,904	120,904	-	-	120,904
Mutual funds	145,699	145,699	145,699	-	-	145,699
Total accrued interest	7,123	7,123	-	7,123	-	7,123
Total fixed income	675,522	675,522	266,603	408,919	-	675,522
U.S. government obligations	1,378,000	1,378,000	-	1,378,000	-	1,378,000
Total U.S. government obligations	1,378,000	1,378,000	-	1,378,000	-	1,378,000
Non-traditional						
Other investments	81,482	81,482	-	81,482	-	81,482
Total non-traditional	81,482	81,482	-	81,482	-	81,482
Total assets whose use is limited	\$ 16,266,164	\$ 16,266,164	\$ 14,397,763	\$ 1,868,401	\$ -	\$ 16,266,164
Liabilities,						
Derivative instrument	\$ 5,024,999	\$ 5,024,999	\$ -	\$ 5,024,999	\$ -	\$ 5,024,999
<b>Disclosed at Fair Value</b>						
Cash and cash equivalents	\$ 4,268,507	\$ 4,268,507	\$ 4,268,507	\$ -	\$ -	\$ 4,268,507
Long-term debt:						
2013 bonds	44,636,041	44,636,041	-	44,636,041	-	44,636,041
Unamortized swap termination fee	3,766,527	3,766,527	-	-	3,766,527	3,766,527
Note payable	149,779	149,780	-	-	149,780	149,780
Construction retainage payable	658,502	658,502	-	-	658,502	658,502

# Fellowship Senior Living, Inc.

## Notes to Financial Statements December 31, 2017 and 2016

### Assets at Fair Value as of December 31, 2016

	Carrying Value	Fair Value	Level 1	Level 2	Level 3	Total
<b>Reported at Fair Value</b>						
Unrestricted assets:						
Investments:						
Cash and money balances	\$ 1,114,295	\$ 1,114,295	\$ 1,114,295	\$ -	\$ -	\$ 1,114,295
Equities:						
Common stock	9,719,235	9,719,235	9,719,235	-	-	9,719,235
Structured products	6,633,003	6,633,003	6,633,003	-	-	6,633,003
Closed end funds and exchange traded products	2,670,946	2,670,946	2,670,946	-	-	2,670,946
Mutual funds	3,193,814	3,193,814	3,193,814	-	-	3,193,814
Other equity investments	289,529	289,529	289,529	-	-	289,529
Unit investment trusts	1,108,182	1,108,182	1,108,182	-	-	1,108,182
Total equities	23,614,709	23,614,709	23,614,709	-	-	23,614,709
Fixed income:						
Corporate bonds and notes	5,706,355	5,706,355	-	5,706,355	-	5,706,355
Certificates of deposit	148,375	148,375	148,375	-	-	148,375
Municipal securities	215,580	215,580	-	215,580	-	215,580
Closed end funds and exchange traded products	398,718	398,718	398,718	-	-	398,718
Mutual funds	3,283,570	3,283,570	3,283,570	-	-	3,283,570
Structured products	5,000	5,000	-	5,000	-	5,000
Preferred securities	573,941	573,941	-	573,941	-	573,941
Total accrued interest	82,466	82,466	-	82,466	-	82,466
Total fixed income	10,414,005	10,414,005	3,830,663	6,583,342	-	10,414,005
Non-traditional:						
Closed end funds and exchange traded products	1,293,111	1,293,111	1,293,111	-	-	1,293,111
Mutual funds	549,310	549,310	549,310	-	-	549,310
Hedge funds	755,462	755,462	-	755,462	-	755,462
Other investments	204,849	204,849	-	204,849	-	204,849
Total non-traditional	2,802,732	2,802,732	1,842,421	960,311	-	2,802,732
Total unrestricted investments in the fair value hierarchy	\$ 37,945,741	\$ 37,945,741	\$ 30,402,088	\$ 7,543,653	\$ -	37,945,741
Investments measured at net asset value (a)						938,545
Investments at fair value						\$ 38,884,286

(a) In accordance with Subtopic 820-10, certain investments that were measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value is presented to reconcile to total investments.

# Fellowship Senior Living, Inc.

## Notes to Financial Statements December 31, 2017 and 2016

### Assets at Fair Value as of December 31, 2016

	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets whose use is limited:						
Cash and money balances	\$ 11,567,302	\$ 11,567,302	\$ 11,567,302	\$ -	\$ -	\$ 11,567,302
Equities:						
Common stock	315,086	315,086	315,086	-	-	315,086
Structured products	51,980	51,980	51,980	-	-	51,980
Closed end funds and exchange traded products	266,838	266,838	266,838	-	-	266,838
Mutual funds	214,564	214,564	214,564	-	-	214,564
Other equity investments	19,980	19,980	19,980	-	-	19,980
Unit investment trusts	103,323	103,323	103,323	-	-	103,323
Total equities	971,771	971,771	971,771	-	-	971,771
Fixed income:						
Corporate bonds and notes	440,237	440,237	-	440,237	-	440,237
Closed end funds and exchange traded products	33,861	33,861	33,861	-	-	33,861
Mutual funds	219,111	219,111	219,111	-	-	219,111
Total accrued interest	8,862	8,862	-	8,862	-	8,862
Total fixed income	702,071	702,071	252,972	449,099	-	702,071
Non-traditional						
Closed end funds and exchange traded product	195,620	195,620	195,620	-	-	195,620
Total non-traditional	195,620	195,620	195,620	-	-	195,620
Total assets whose use is limited	<u>\$ 13,436,764</u>	<u>\$ 13,436,764</u>	<u>\$ 12,987,665</u>	<u>\$ 449,099</u>	<u>\$ -</u>	<u>\$ 13,436,764</u>
Liabilities,						
Derivative instrument	<u>\$ 5,135,496</u>	<u>\$ 5,135,496</u>	<u>\$ -</u>	<u>\$ 5,135,496</u>	<u>\$ -</u>	<u>\$ 5,135,496</u>
<b>Disclosed at Fair Value</b>						
Cash and cash equivalents	\$ 3,051,577	\$ 3,051,577	\$ 3,051,577	\$ -	\$ -	\$ 3,051,577
Long-term debt:						
2013 bonds	43,969,989	43,969,989	-	43,969,989	-	43,969,989
Unamortized swap termination fee	4,051,541	4,051,541	-	-	4,051,541	4,051,541
Note payable	216,344	216,344	-	-	216,344	216,344

## Fellowship Senior Living, Inc.

Notes to Financial Statements  
December 31, 2017 and 2016

The following is a description of the valuation methodologies used for assets measured at fair value and for financial instruments disclosed at fair value. There have been no changes in methodologies used at December 31, 2017 and December 31, 2016:

The carrying amounts of cash and cash equivalents approximate fair value due to the short-term nature of those instruments.

Mutual funds and equities are valued at fair value based on quoted market prices which are considered Level 1 inputs. Debt securities are valued using quoted market prices of similar securities, which are considered Level 2 inputs.

Non-traditional are valued by an independent advisor that values the underlying investments of the funds, which are substantially invested in an active market in which the individual securities are traded. The non-traditional investments are comprised of limited partnerships that invest primarily in securities that are traded in active markets.

The fair value of the long-term debt is based on quoted market prices for the same or similar issues.

FSL measures its derivative financial instruments at fair value based on proprietary models of the maker of the instrument based upon estimated future cash flows and forecasted interest rate yields. This value represents the estimated amount FSL would receive or pay upon termination of the agreement, taking into consideration current interest rates.

### 5. Property and Equipment

Property and equipment consist of the following at December 31:

	<u>2017</u>	<u>2016</u>
Land	\$ 6,400,000	\$ 6,400,000
Land improvements	629,213	628,070
Buildings	85,570,345	86,471,962
Furnishings and equipment	<u>25,964,322</u>	<u>23,708,661</u>
	118,563,880	117,208,693
Less accumulated depreciation and amortization	<u>(65,646,651)</u>	<u>(60,366,041)</u>
	52,917,229	56,842,652
Construction in progress	<u>15,718,204</u>	<u>7,147,977</u>
Total	<u>\$ 68,635,433</u>	<u>\$ 63,990,629</u>

Interest costs capitalized were \$334,438 and \$292,619 during 2017 and 2016, respectively.

## Fellowship Senior Living, Inc.

Notes to Financial Statements  
December 31, 2017 and 2016

During 2010, FSL entered into an agreement with Morrison Dining Services ("Morrison") for the renovation of the dining facilities. Under the agreement, Morrison advanced FSL \$1,300,000 for the construction project. FSL is required to repay Morrison \$650,000, which is included in long-term debt as a note payable. The note payable was \$149,779 and \$216,344 at December 31, 2017 and December 31, 2016, respectively. The portion of the advance which is not required to be repaid is recorded as deferred revenue of \$150,000 and \$216,666 at December 31, 2017 and December 31, 2016, respectively and is being recognized as other revenue over the term of the contract.

During 2017, FSL commenced a new construction and renovation project. Payments to the General Contractor are approved by the financial institutions managing the bond proceeds. A construction retainage of 10% is withheld as payment from each requisition and is payable to the general contractor upon completion of each phase of the project. This retainage of \$658,502 is recorded as a long term liability and is also included in Construction in Progress. As of December 31, 2017, the approved budget commencing on April 19, 2017, for the project is approximately \$58.7 million in aggregate, in which approximately \$7.3 million has been completed.

FSL has recorded accelerated depreciation on fixed assets that are being replaced and/or renovated as part of the new construction phase of the project. Assets with a remaining net book value as of April 19, 2017, the commencement of construction, are being depreciated over the expected duration of the project, 36 months. For the period ending December 31, 2017, the portion of depreciation that is classified as accelerated is \$1,691,433.

### 6. Long-Term Debt

Long-term debt consists of the following at December 31:

	<u>2017</u>	<u>2016</u>
Series 2013B Public Finance Authority (the "Authority"), Revenue and Refunding Bonds due in varying installments through 2035 plus interest at 3.389% starting in October 1, 2016 and 3.377% in 2015 and first 9 months in 2016. The Bonds are collateralized by a mortgage, the assignment of leases and rent, and a security agreement.	\$ 40,567,665	\$ 43,919,989
Series 2013A Public Finance Authority (the "Authority"), Revenue and Refunding Bonds due in varying installments through 2035 plus interest at 3.965%. The Bonds are collateralized by a mortgage, the assignment of leases and rent, and a security agreement.	4,068,376	50,000
Unamortized swap termination fee	3,766,527	4,051,541
Construction retainage payable	658,502	-
Note payable, Morrison (interest free)	149,779	216,344
Total debt	49,210,849	48,237,874
Less: current portion	3,894,569	3,703,904
deferred financing costs	1,267,755	1,386,460
Total	<u>\$ 44,048,525</u>	<u>\$ 43,147,510</u>

## Fellowship Senior Living, Inc.

Notes to Financial Statements  
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On December 30, 2013, the Authority issued on behalf of FSL, 2013A and 2013B fixed rate revenue bonds (the "Series 2013 Bonds"), which consist of \$45,000,000 Series 2013A and \$51,500,000 Series 2013B. Proceeds from the Series 2013B Bonds were used for the following: (a) to refund the 2008 Variable Rate Revenue Bonds; (b) pay certain costs incurred in connection with the issuance of the Series 2013 Bonds and (c) pay off the interest rate swap agreement associated with the 2008 Variable Rate Revenue Bonds. As of December 31, 2017 and 2016, respectively, \$4,068,376 and \$50,000 was drawn down on the Series 2013 bonds. The balance of these funds are available to finance certain improvements to the property owned and operated by FSL.

On July 9, 2010, FSL entered into an interest free note payable of \$650,000 with Morrison Dining Services for the renovation of FSL's dining area. The note will be repaid monthly until 2020.

In connection with FSL's issuance of the Series 2013 Bonds, FSL entered into interest rate swap agreements to convert the variable interest bond rates to fixed interest rates. These agreements were terminated under a refinancing of these bonds in December 2016 and new agreements entered into. Under the terms of the Series 2013A and Series 2013B Bond refinancing and new interest rate swap agreements, FSL pays fixed interest rates of 3.965% and 3.389%, respectively, and receives 65% times two months LIBOR plus 120 basis points. The notional amount of the swap agreements correspond to the outstanding principal balance of the Series 2013 Bonds.

Approximate principal payments on long-term debt for the next five years follow:

	Note Payable	2013 Bonds	Unamortized Swap Termination Fee	Construction Retainage	Total
2018	\$ 66,567	\$ 3,467,643	\$ 360,359	\$ -	\$ 3,894,569
2019	66,567	3,586,930	473,425	658,502	4,785,424
2020	16,645	3,710,321	520,892	-	4,247,858
2021	-	3,837,956	488,780	-	4,326,736
2022	-	3,969,981	455,592	-	4,425,573
Thereafter	-	26,063,210	1,467,479	-	27,530,689
Total	<u>\$ 149,779</u>	<u>\$ 44,636,041</u>	<u>\$ 3,766,527</u>	<u>\$ 658,502</u>	<u>\$ 49,210,849</u>

### 7. Temporarily Restricted Net Assets

Temporarily restricted net assets consist of the following at December 31:

	2017	2016
Capital Fund	\$ 779,851	\$ -
Resident's Benevolent Fund	278,999	292,138
Community Renewal Fund	13,074	565,500
Legacy Endowment Fund	888,670	779,862
Total	<u>\$ 1,960,594</u>	<u>\$ 1,637,500</u>

## Fellowship Senior Living, Inc.

Notes to Financial Statements  
December 31, 2017 and 2016

### 8. Functional Expenses

FSL provides residential and health care services to residents and other patients within its geographic area. Expenses related to providing these services are as follows for the twelve months ending December 31:

	<u>2017</u>	<u>2016</u>
Resident services	\$ 5,443,721	\$ 5,433,583
Health care services	12,166,840	12,079,252
Home community based services	6,150,878	6,127,139
General and administrative (including interest and depreciation and amortization)	<u>14,523,232</u>	<u>13,011,391</u>
Total	<u>\$ 38,284,671</u>	<u>\$ 36,651,365</u>

### 9. Contingencies

FSL is regulated by the New Jersey Department of Community Affairs ("DCA") pursuant to the Continuing Care Retirement Community Regulation and Financial Disclosures Act (the "Act"). The Act requires, among other things, that Fellowship Senior Living establish an escrow account into which substantially all advance fees must be deposited until certain conditions are satisfied and, upon issuance of a certificate of authority by the DCA, FSL must establish and maintain liquid reserves which generally are equal to 15% of the projected operating expenses (excluding depreciation) related to contract residents. FSL has complied with those requirements at December 31, 2017 and at December 31, 2016.

#### Senior Living Services Industry

The senior living services industry is subject to numerous laws, regulations, and administrative directives of federal, state, and local governments and agencies. Compliance with these laws, regulations, and administrative directives is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity has continued to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for resident services previously billed. Management is not aware of any material incidents of noncompliance.

### 10. Retirement Plan

FSL sponsors a 401(k) defined contribution plan (the "Plan"). Under the Plan, FSL makes annual matching contributions to the Plan of 100% of the first 1% plus 50% of the next 5% of compensation that a participant contributes to the Plan not to exceed 3 ½% of compensation, as defined by the Plan. Employees are eligible to participate in the plan upon completion of at least 1,000 hours of service. Employees become 100% vested in employee contributions immediately upon their participation. The employer matching contributions are subject to a five-year vesting schedule. Pension expense for FSL under the Plan was approximately \$308,100 and \$280,945 for the twelve months ending December 31, 2017 and 2016, respectively.

## **Fellowship Senior Living, Inc.**

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Notes to Financial Statements  
December 31, 2017 and 2016

### **11. Concentrations**

FSL maintains cash accounts, which, at times, may exceed federally insured limits. FSL has not experienced any losses from maintaining cash accounts in excess of federally insured limits. Management believes that it is not subject to any significant credit risk on its cash accounts.

FSL grants credit without collateral to its residents, primarily related to providing residential and healthcare related services.