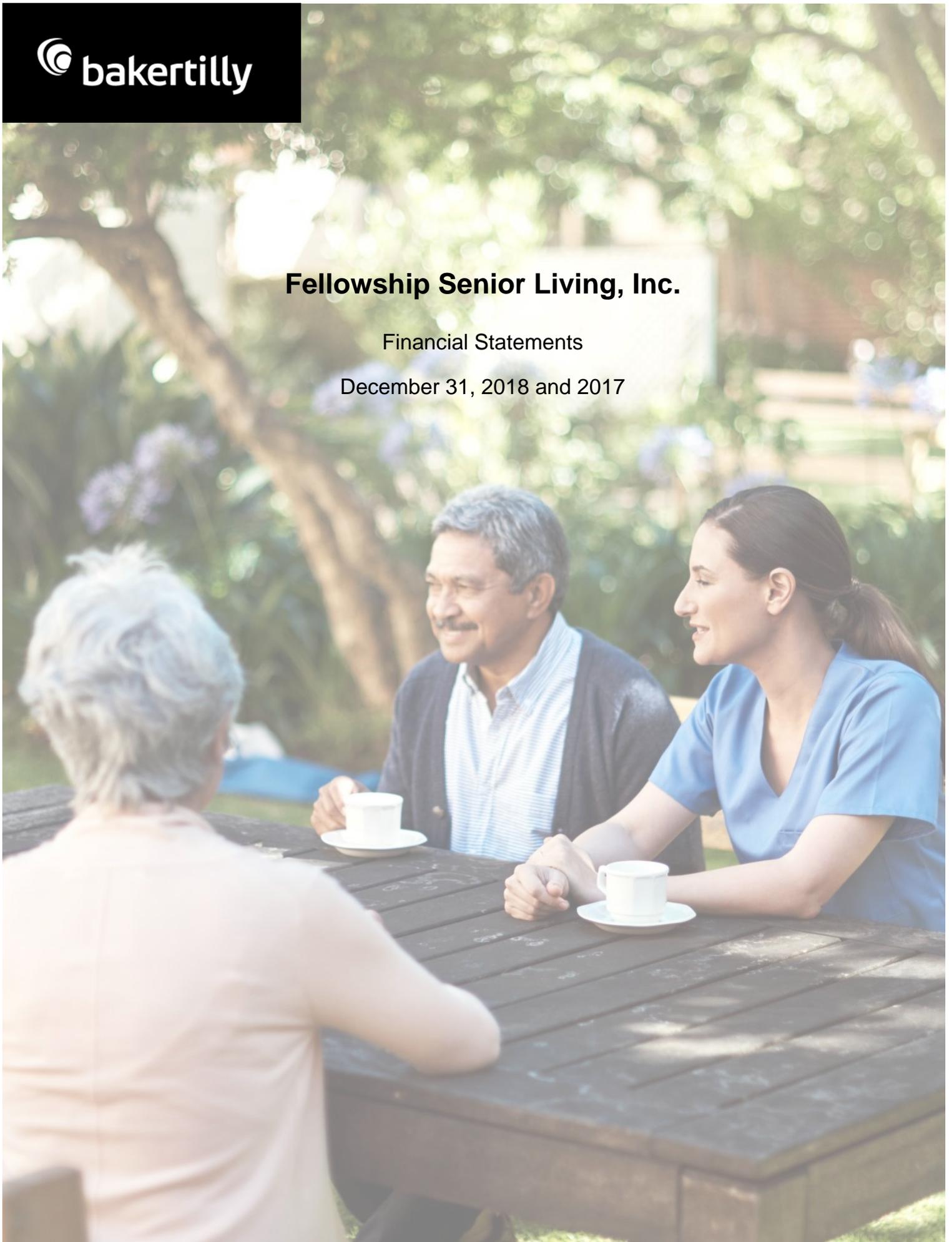




Fellowship Senior Living, Inc.

Financial Statements

December 31, 2018 and 2017



Fellowship Senior Living, Inc.

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Independent Auditors' Report

To the Board of Directors of
Fellowship Senior Living, Inc.

We have audited the accompanying financial statements of Fellowship Senior Living, Inc. ("FSL"), which comprise the balance sheets as of December 31, 2018 and 2017, 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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, 2018 and 2017, and the results of its operations, changes in its net assets, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, the 2018 financial statements have been restated to correct an error. Our opinion is not modified with respect to this matter.

Baker Tilly Virchow Krause, LLP

Iselin, New Jersey

April 30, 2019, except as to the restatement subsection of Note 1 and the restated portions of Notes 5, 7 and 9, which are as of November 26, 2019

Fellowship Senior Living, Inc.

Balance Sheets

December 31, 2018 and 2017

| | <u>2018</u> | <u>2017</u> |
|---|-----------------------|-----------------------|
| | <u>(Restated)</u> | <u>(Restated)</u> |
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 3,157,188 | \$ 4,268,507 |
| Investments | 28,569,270 | 38,548,919 |
| Assets whose use is limited, current portion | 11,816,535 | 10,208,723 |
| Accounts receivable, net of allowance for doubtful accounts of \$171,040 in 2018 and \$116,815 in 2017 | 3,462,004 | 2,662,402 |
| Supplies and other current assets | <u>1,415,784</u> | <u>1,199,353</u> |
| Total current assets | 48,420,781 | 56,887,904 |
| Noncurrent Assets Whose Use is Limited | 4,800,258 | 6,057,441 |
| Property and Equipment, Net | 87,619,715 | 68,635,433 |
| Long-Term Deposits | <u>88,532</u> | <u>80,929</u> |
| Total assets | <u>\$ 140,929,286</u> | <u>\$ 131,661,707</u> |
| Liabilities and Net Assets | | |
| Current Liabilities | | |
| Accounts payable and accrued expenses | \$ 3,831,090 | \$ 3,639,386 |
| Accrued interest payable | 497,389 | 357,762 |
| Current portion of long-term debt | <u>3,600,245</u> | <u>3,534,210</u> |
| Total current liabilities | 7,928,724 | 7,531,358 |
| Refundable waiting list deposits | 275,045 | 272,481 |
| Refundable advance fees | 14,247,608 | 16,676,471 |
| Deferred revenue from advance fees | 19,255,797 | 19,617,605 |
| Deferred revenue from forward delivery agreements | 752,448 | 877,856 |
| Deferred revenue from renovations | 1,090,013 | 150,000 |
| Long-term debt, net | 53,137,444 | 40,642,357 |
| Derivative instruments | <u>3,915,862</u> | <u>5,024,999</u> |
| Total liabilities | <u>100,602,941</u> | <u>90,793,127</u> |
| Net Assets | | |
| Without donor restrictions | 38,227,970 | 38,907,986 |
| With donor restrictions | <u>2,098,375</u> | <u>1,960,594</u> |
| Total net assets | <u>40,326,345</u> | <u>40,868,580</u> |
| Total liabilities and net assets | <u>\$ 140,929,286</u> | <u>\$ 131,661,707</u> |

See notes to financial statements

Fellowship Senior Living, Inc.

Statements of Operations and Changes in Net Assets
Years Ended December 31, 2018 and 2017

| | <u>2018</u> <u>(Restated)</u> | <u>2017</u> <u>(Restated)</u> |
|--|----------------------------------|----------------------------------|
| Net Assets Without Donor Restrictions | | |
| Revenue: | | |
| Resident services, including amortization of advance fees of \$7,545,952 in 2018 and \$8,022,402 in 2017 | \$ 25,861,953 | \$ 26,527,125 |
| Patient revenue from nonresidents | 6,287,921 | 5,291,956 |
| Home community based services, including amortization of advance fees of \$174,997 in 2018 and \$155,591 in 2017 | 6,659,161 | 5,112,103 |
| Investment income and other revenue, net | 5,520,188 | 5,835,616 |
| | <u>44,329,223</u> | <u>42,766,800</u> |
| Total revenue | | |
| Expenses: | | |
| Salaries and benefits | 20,507,130 | 18,647,569 |
| Contracted services | 5,442,503 | 5,204,536 |
| Supplies and other | 7,802,134 | 7,384,900 |
| Interest | 907,521 | 1,199,456 |
| Depreciation | 4,187,853 | 4,344,078 |
| Provision for bad debt | 94,268 | 97,713 |
| | <u>38,941,409</u> | <u>36,878,252</u> |
| Total expenses | | |
| Income from operations before accelerated depreciation | 5,387,814 | 5,888,548 |
| Accelerated depreciation | 2,537,126 | 1,691,433 |
| | <u>2,850,688</u> | <u>4,197,115</u> |
| Income from operations | | |
| Loss on disposal of property and equipment | (148,313) | (306,619) |
| Net change in unrealized (loss) gain on investments | (4,507,089) | 2,202,219 |
| Non-operating gain | 15,561 | - |
| Net change in fair value of derivative instrument | 1,109,137 | 110,497 |
| | <u>(680,016)</u> | <u>6,203,212</u> |
| (Deficiency) excess of revenue over expenses | | |
| (Decrease) increase in net assets without donor restrictions | <u>(680,016)</u> | <u>6,203,212</u> |
| Net Assets with Donor Restrictions | | |
| Gross contributions | 432,377 | 279,293 |
| Net assets released from restriction | (101,211) | (114,769) |
| Interest income | 59,114 | 77,440 |
| Net change in unrealized (loss) gain on investments | (252,499) | 81,130 |
| | <u>137,781</u> | <u>323,094</u> |
| Increase in net assets with donor restrictions | | |
| (Decrease) increase in net assets | <u>(542,235)</u> | <u>6,526,306</u> |
| Net Assets, Beginning of Year | | |
| | <u>40,868,580</u> | <u>34,342,274</u> |
| Net Assets, End of Year | | |
| | <u>\$ 40,326,345</u> | <u>\$ 40,868,580</u> |

See notes to financial statements

Fellowship Senior Living, Inc.

Statements of Cash Flows

Years Ended December 31, 2018 and 2017

| | 2018 | 2017 |
|--|---------------------|---------------------|
| | (Restated) | (Restated) |
| Cash Flows from Operating Activities | | |
| (Decrease) increase in net assets | \$ (542,235) | \$ 6,526,306 |
| Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities: | | |
| Cash received from advance fees and waiting list deposits, net | 4,932,842 | 8,009,404 |
| Amortization of advance fees | (7,720,949) | (8,177,993) |
| Amortization of deferred revenue from renovations | (59,987) | (66,666) |
| Amortization of deferred financing costs | 125,459 | 147,798 |
| Loss on disposal of property and equipment | 148,313 | 306,619 |
| Contributions restricted for capital projects | (397,428) | (212,302) |
| Amortization of forward delivery agreements | (125,408) | (125,408) |
| Depreciation | 6,724,979 | 6,035,511 |
| Net change in unrealized gain on investments | 4,759,588 | (2,283,349) |
| Net change in fair value of derivative instrument | (1,109,137) | (110,497) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (799,602) | 233,806 |
| Supplies and other current assets | (216,431) | (218,640) |
| Other long-term assets | (7,603) | 30,237 |
| Accounts payable and accrued expenses | 191,704 | 893,249 |
| Accrued interest payable | 139,627 | (14,725) |
| Net cash provided by operating activities | <u>6,043,732</u> | <u>10,973,350</u> |
| Cash Flows from Investing Activities | | |
| Net sales (purchases) of investments and assets whose use is limited | 4,869,432 | (210,684) |
| Acquisition of property and equipment | <u>(25,857,574)</u> | <u>(10,986,934)</u> |
| Net cash used in investing activities | <u>(20,988,142)</u> | <u>(11,197,618)</u> |
| Cash Flows from Financing Activities | | |
| Payment of deferred financing costs | - | (29,092) |
| Proceeds from issuance of long-term debt | 13,990,525 | 4,018,376 |
| Proceeds received for renovations | 1,000,000 | - |
| Contributions restricted for capital projects | 397,428 | 212,302 |
| Principal payments of long-term debt | (3,494,273) | (3,418,890) |
| Construction retainage payable | <u>1,939,411</u> | <u>658,502</u> |
| Net cash provided by financing activities | <u>13,833,091</u> | <u>1,441,198</u> |
| Net (decrease) increase in cash and cash equivalents | (1,111,319) | 1,216,930 |
| Cash and Cash Equivalents, Beginning | <u>4,268,507</u> | <u>3,051,577</u> |
| Cash and Cash Equivalents, Ending | <u>\$ 3,157,188</u> | <u>\$ 4,268,507</u> |
| Supplemental Disclosure of Cash Flow Information | | |
| Cash paid for interest | <u>\$ 1,534,124</u> | <u>\$ 1,400,822</u> |

See notes to financial statements

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

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 Basking Ridge, 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 months 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 with donor restrictions.

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.

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 managers or general partner of the funds. 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.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

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

Supplies

Supplies are carried at the lower of cost or net realizable value. Cost is defined by using the first-in, first-out method of accounting.

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 40 years).

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.

The advance fee deposits are refundable to the residents upon termination of the residency 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, 2018 and 2017, 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.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

Deferred Revenue from Renovations

Deferred revenue from renovations relates to an initial \$650,000 received to renovate FSL's dining facilities (see Note 6). FSL received an additional \$1,000,000 in 2018 to create and enhance the dining areas in the households within the new Health Center addition. The unamortized balance of the initial \$650,000 was restructured as of April 1, 2018 and will be recognized into revenue over a ten-year period ending March 2028 using the straight-line method. The additional \$1,000,000 received will be amortized as of October 1, 2018 and recognized into revenue over a 114-month period ending March 2028 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 two (2) terminated derivative instruments: Two (2) for Series 2013A Bonds and two (2) for Series 2013B Bonds.

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

As of December 31, 2018:

| Bond Issues | Notional Amount | Fixed Rate | Variable Rate | Period |
|----------------------------|------------------------|-------------------|-----------------------------------|-------------------------------|
| Series 2013 A Bonds | \$ 23,164,829 | 3.99% and 3.945% | LIBOR x 65% plus 120 basis points | October 2017 to December 2026 |
| Series 2013 B Bonds | \$ 37,100,023 | 3.385% and 3.393% | LIBOR x 65% plus 120 basis points | October 2016 to December 2026 |

FSL recognizes the derivative instruments as either an asset or liability at fair value within the accompanying balance sheets. 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 (deficiency) 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 \$3,915,862 and \$5,024,999 at December 31, 2018 and December 31 2017, 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 net assets with donor restrictions 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, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the statements of operations and changes in net assets as net assets released from restrictions.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

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, 2018 and 2017, pledges receivable of \$159,300 and \$132,846, respectively, are fully reserved.

Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions

Net assets available for use in general operations and not subject to donor restrictions. All revenue not restricted by donors and donor restricted contributions whose restrictions are met in the same period in which they are received are accounted for in net assets without donor restrictions.

Net Assets With Donor Restrictions

Some donor imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. All revenues restricted by donors as to either timing or purpose of the related expenditures or required to be maintained in perpetuity as a source of investment income are accounted for in net assets with donor restrictions. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions.

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 and reviews. 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 provided, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits and reviews.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

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 (deficiency) excess of revenue over expenses as the performance indicator. Changes in net assets without donor restrictions which are excluded from the (deficiency) excess of revenue over expense, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

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. FSL incurred and expensed advertising costs of approximately \$327,000 and \$322,000 costs for the twelve months ended December 31, 2018 and 2017, respectively.

General and Professional Liability

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

Income Taxes

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

Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU No. 2014-09 supersedes the revenue recognition requirements in *Topic 605, Revenue Recognition*, and most industry-specific guidance. Under the requirements of ASU No. 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 No. 2014-09 for years beginning after December 15, 2018. FSL has not yet determined the impact of adoption of ASU No. 2014-09 on its financial statements.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

Presentation of Financial Statements

In 2018, FSL adopted the FASB ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. FSL has adjusted the presentation of these financial statements accordingly. ASU No. 2016-14 has been applied retrospectively to all periods presented, except for the disclosures around liquidity and availability of resources and analysis of expenses by nature and function. These disclosures have been presented for 2018 only, as allowed by ASU No. 2016-14.

- The new standard changes the following aspects of the financial statements:
- The unrestricted net assets class has been renamed net assets without donor restrictions;
- The temporarily restricted net asset class has been renamed net assets with donor restrictions;
- Investment expenses are included in investment income, net
- The financial statements include a disclosure about liquidity and availability of resources at December 31, 2018. (Note 4).
- The functional expense disclosure for 2018 includes expenses reported both by nature and function (Note 9).

Reclassification

Certain 2017 amounts have been reclassified to conform to the 2018 presentation.

Subsequent Events

FSL evaluated subsequent events for recognition or disclosure through April 30, 2019, the date the financial statements were available to be issued.

Restatement

FSL restated its previously issued 2018 and 2017 financial statements to correct an error, which was caused by an oversight in the recognition and measurement of a swap termination liability and resulting amortization recorded in the 2018 and 2017 financial statements. The tables in Notes 5, 7 and 9, and the disclosure related to the swap termination liability in Note 7, were also restated to correct the error.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

The effects of the restatement on the 2018 financial statements are as follows:

| | <u>As Previously Reported</u> | <u>Adjustment</u> | <u>As Restated</u> |
|--|-----------------------------------|-------------------|--------------------|
| Balance Sheet | | | |
| Current liabilities: | | | |
| Current portion of long-term debt | \$ 4,073,490 | \$ (473,245) | \$ 3,600,245 |
| Total current liabilities | 8,401,969 | (473,245) | 7,928,724 |
| Long-term debt, net | 56,070,367 | (2,932,923) | 53,137,444 |
| Total liabilities | 104,009,109 | (3,406,168) | 100,602,941 |
| Net assets: | | | |
| Net assets without donor restrictions | 34,821,802 | 3,406,168 | 38,227,970 |
| Total net assets | 36,920,177 | 3,406,168 | 40,326,345 |
| Statement of Operations and Changes in Net Assets | | | |
| Interest | 547,162 | 360,359 | 907,521 |
| Total expenses | 38,581,050 | 360,359 | 38,941,409 |
| Deficiency of revenue over expenses | (319,657) | (360,359) | (680,016) |
| Decrease in net assets without donor restrictions | (319,657) | (360,359) | (680,016) |
| Decrease in net assets | (181,876) | (360,359) | (542,235) |
| Net Assets, Beginning of Year | 37,102,053 | 3,766,527 | 40,868,580 |
| Net Assets, End of Year | 36,920,177 | 3,406,168 | 40,326,345 |
| Consolidated Statement of Cash Flows | | | |
| Cash flows from operating activities: | | | |
| (Decrease) increase in net assets | (181,876) | (360,359) | (542,235) |
| Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities: | | | |
| Amortization of swap termination fees | (360,359) | 360,359 | - |

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

The effects of the restatement on the 2017 financial statements are as follows:

| | <u>As Previously Reported</u> | <u>Adjustment</u> | <u>As Restated</u> |
|---|-----------------------------------|-------------------|--------------------|
| Balance Sheet | | | |
| Current liabilities: | | | |
| Current portion of long-term debt | \$ 3,894,569 | \$ (360,359) | \$ 3,535,310 |
| Total current liabilities | 7,891,717 | (360,359) | 7,531,358 |
| Long-term debt, net | 44,048,525 | (3,406,168) | 40,642,357 |
| Total liabilities | 94,559,654 | (3,766,527) | 90,793,127 |
| Net assets: | | | |
| Net assets without donor restrictions | 35,141,459 | 3,766,527 | 38,907,986 |
| Total net assets | 37,102,053 | 3,766,527 | 40,868,580 |
| Statement of Operations and Changes in Net Assets | | | |
| Interest | 914,442 | 285,014 | 1,199,456 |
| Total expenses | 36,593,238 | 285,014 | 36,878,252 |
| Excess of revenue over expenses | 6,488,226 | (285,014) | 6,203,212 |
| Increase in net assets without donor restrictions | 6,488,226 | (285,014) | 6,203,212 |
| Increase in net assets | 6,811,320 | (285,014) | 6,526,306 |
| Net Assets, Beginning of Year | 30,290,733 | 4,051,541 | 34,342,274 |
| Net Assets, End of Year | 37,102,053 | 3,766,527 | 40,868,580 |
| Statement of Cash Flows | | | |
| Cash flows from operating activities: | | | |
| Increase in net assets | 6,811,320 | (285,014) | 6,526,306 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | | |
| Amortization of swap termination fees | (285,014) | 285,014 | - |

2. Medicare Reimbursement System

FSL provides care to patients under Medicare. Revenue from the Medicare program accounted for approximately 9% of the revenue for both of the twelve months ended December 31, 2018 and 2017. Future changes in the Medicare program and any reduction of funding could have an adverse impact on FSL. 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. FSL 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.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

3. Investments and Assets Whose Use is Limited

Investments consist of the following at December 31:

| | <u>2018</u> | <u>2017</u> |
|-----------------------------|----------------------|----------------------|
| Cash and money market funds | \$ 748,607 | \$ 554,082 |
| Equities | 17,845,936 | 27,580,198 |
| Fixed income | 7,457,005 | 8,488,485 |
| Alternative investments | 2,368,061 | 1,839,785 |
| Other | 77,950 | 6,500 |
| Accrued interest | 71,711 | 79,869 |
| Total | <u>\$ 28,569,270</u> | <u>\$ 38,548,919</u> |

Above investments, at cost, are \$32,376,593 and \$37,972,846 at December 31, 2018 and December 31, 2017, respectively.

Assets whose use is limited consist of the following:

| | <u>2018</u> | <u>2017</u> |
|---|---------------------|---------------------|
| Bond indenture agreements, held by trustees: | | |
| Cash and cash equivalents | \$ 13,119,375 | \$ 12,513,930 |
| Corporate bonds and notes | 1,087,841 | - |
| U.S. Government obligations | - | 1,378,000 |
| Total | <u>14,207,216</u> | <u>13,891,930</u> |
| Waiting list and entrance fee deposits: | | |
| Cash and cash equivalents | 35,217 | 110,562 |
| Equities | 224,989 | 234,014 |
| Fixed income | 50,332 | 68,232 |
| Accrued interest | 664 | 832 |
| Total | <u>311,202</u> | <u>413,640</u> |
| Assets with donor restriction: | | |
| Cash and cash equivalents | 265,702 | 73,548 |
| Equities | 1,268,484 | 1,199,106 |
| Fixed income | 479,654 | 600,167 |
| Other | 77,715 | 81,482 |
| Accrued interest | 6,820 | 6,291 |
| Total | <u>2,098,375</u> | <u>1,960,594</u> |
| Total assets whose use is limited | 16,616,793 | 16,266,164 |
| Less assets whose use is limited, current portion | <u>11,816,535</u> | <u>10,208,723</u> |
| Noncurrent assets whose use is limited | <u>\$ 4,800,258</u> | <u>\$ 6,057,441</u> |

These investments, excluding net assets with donor restriction, at cost aggregated are \$14,522,231 and \$14,278,854 at December 31, 2018 and December 31, 2017, respectively.

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

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

| | <u>2018</u> | <u>2017</u> |
|---|----------------------|----------------------|
| Debt service reserve funds | \$ 3,547,743 | \$ 3,547,743 |
| Debt service funds for principal and interest | 4,985,767 | 4,900,519 |
| Debt service construction fund | <u>5,673,706</u> | <u>5,443,668</u> |
| Total | <u>\$ 14,207,216</u> | <u>\$ 13,891,930</u> |

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

| | <u>2018</u> | <u>2017</u> |
|------------------------------|---------------------|---------------------|
| Interest and dividend income | \$ 1,297,219 | \$ 1,630,644 |
| Investment fees | (36,188) | (45,905) |
| Net realized gain | <u>301,220</u> | <u>473,580</u> |
| Total | <u>\$ 1,562,251</u> | <u>\$ 2,058,319</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 both of the twelve months ended December 31, 2018 and 2017, FSL has recorded \$125,408 related to the amortization of the funds received, which is included in other revenue. At December 31, 2018 and December 31, 2017, FSL has recorded deferred revenue of approximately \$752,000 and \$878,000 respectively, related to the agreements.

4. Liquidity and Availability of Resources

As of December 31, 2018, FSL has financial assets available for general expenditure within one year of the balance sheet date, consisting of the following:

| | |
|---------------------------|----------------------|
| Cash and cash equivalents | \$ 3,157,188 |
| Accounts receivable, net | 3,462,004 |
| Investments | <u>28,569,270</u> |
| Total | <u>\$ 35,188,462</u> |

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

FSL has investments which are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above. FSL has other assets limited to use held by trustee under trust indenture. Additionally, certain other debt service funds are designated for long-term purposes. These investments, which are more fully described in Note 3, are not available for general expenditure within the next year and are not reflected in the amounts above.

FSL designated a portion of its investments "reserved" to comply with state and lender liquid reserve requirements. Although FSL does not intend to utilize the required liquid reserves for general expenditures as part of its annual budget and approval process, amounts designated for state and lender required liquid reserves could be made available as necessary.

As part of FSL's liquidity management plan, cash in excess of daily requirements are invested in short-term investments and money market funds. As of December 31, 2018, FSL has unrestricted cash and investments to cover 345 days of operating expenses. FSL's practice is to structure its financial assets to be available as its general expenditures, liabilities and other obligations become due.

5. 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, 2018 and 2017

The following tables present the financial instruments carried at fair value as of December 31, 2018 by caption on the balance sheets and within the valuation hierarchy levels defined above:

| | Assets at Fair Value as of December 31, 2018 | | | | | |
|---|--|---------------|---------------|--------------|---------|---------------|
| | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 | Total |
| Reported at Fair Value | | | | | | |
| Assets without donor restrictions: | | | | | | |
| Investments: | | | | | | |
| Cash and money balances | \$ 748,607 | \$ 748,607 | \$ 748,607 | \$ - | \$ - | \$ 748,607 |
| Equities: | | | | | | |
| Common stock | 10,075,495 | 10,075,495 | 10,075,495 | - | - | 10,075,495 |
| Structured products | 3,272,880 | 3,272,880 | 3,272,880 | - | - | 3,272,880 |
| Closed end funds and exchange traded products | 2,918,948 | 2,918,948 | 2,918,948 | - | - | 2,918,948 |
| Mutual funds | 1,141,939 | 1,141,939 | 1,141,939 | - | - | 1,141,939 |
| Other equity investments | 174,880 | 174,880 | 174,880 | - | - | 174,880 |
| Unit investment trusts | 261,794 | 261,794 | 261,794 | - | - | 261,794 |
| Total equities | 17,845,936 | 17,845,936 | 17,845,936 | - | - | 17,845,936 |
| Fixed income: | | | | | | |
| Corporate bonds and notes | 4,504,554 | 4,504,554 | - | 4,504,554 | - | 4,504,554 |
| Certificates of deposit | 248,107 | 248,107 | 248,107 | - | - | 248,107 |
| Municipal securities | 201,886 | 201,886 | - | 201,886 | - | 201,886 |
| Closed end funds and exchange traded products | 1,879,539 | 1,879,539 | 1,879,539 | - | - | 1,879,539 |
| Mutual funds | 620,919 | 620,919 | 620,919 | - | - | 620,919 |
| Structured products | 2,000 | 2,000 | - | 2,000 | - | 2,000 |
| Total accrued interest | 71,711 | 71,711 | - | 71,711 | - | 71,711 |
| Total fixed income | 7,528,716 | 7,528,716 | 2,748,565 | 4,780,151 | - | 7,528,716 |
| Non-traditional: | | | | | | |
| Mutual funds | 67,360 | 67,360 | 67,360 | - | - | 67,360 |
| Hedge funds | 726,385 | 726,385 | - | 726,385 | - | 726,385 |
| Other investments | 719,836 | 719,836 | - | 719,836 | - | 719,836 |
| Total non-traditional | 1,513,581 | 1,513,581 | 67,360 | 1,446,221 | - | 1,513,581 |
| Total assets without donor restrictions in the fair value hierarchy | \$ 27,636,840 | \$ 27,636,840 | \$ 21,410,468 | \$ 6,226,372 | \$ - | 27,636,840 |
| Investments measured at net asset value (a) | | | | | | 932,430 |
| Investments at fair value | | | | | | \$ 28,569,270 |

(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, 2018 and 2017

| | Assets and Liabilities at Fair Value as of December 31, 2018 | | | | | |
|---|--|---------------|---------------|--------------|--------------|---------------|
| | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 | Total |
| Assets whose use is limited: | | | | | | |
| Cash and money balances | \$ 13,420,294 | \$ 13,420,294 | \$ 13,420,294 | \$ - | \$ - | \$ 13,420,294 |
| Equities: | | | | | | |
| Common stock | 646,962 | 646,962 | 646,962 | - | - | 646,962 |
| Structured products | 53,900 | 53,900 | 53,900 | - | - | 53,900 |
| Closed end funds and exchange traded products | 635,189 | 635,189 | 635,189 | - | - | 635,189 |
| Mutual funds | 149,970 | 149,970 | 149,970 | - | - | 149,970 |
| Other equity investments | 7,452 | 7,452 | 7,452 | - | - | 7,452 |
| Total equities | 1,493,473 | 1,493,473 | 1,493,473 | - | - | 1,493,473 |
| Fixed income: | | | | | | |
| Corporate bonds and notes | 1,442,616 | 1,442,616 | - | 1,442,616 | - | 1,442,616 |
| Closed end funds and exchange traded products | 113,730 | 113,730 | 113,730 | - | - | 113,730 |
| Mutual funds | 61,481 | 61,481 | 61,481 | - | - | 61,481 |
| Total accrued interest | 7,484 | 7,484 | - | 7,484 | - | 7,484 |
| Total fixed income | 1,625,311 | 1,625,311 | 175,211 | 1,450,100 | - | 1,625,311 |
| Non-traditional: | | | | | | |
| Other investments | 77,715 | 77,715 | - | 77,715 | - | 77,715 |
| Total non-traditional | 77,715 | 77,715 | - | 77,715 | - | 77,715 |
| Total assets whose use is limited | \$ 16,616,793 | \$ 16,616,793 | \$ 15,088,978 | \$ 1,527,815 | \$ - | \$ 16,616,793 |
| Liabilities: | | | | | | |
| Derivative instrument | \$ 3,915,862 | \$ 3,915,862 | \$ - | \$ - | \$ 3,915,862 | \$ 3,915,862 |
| Disclosed at Fair Value (restated) | | | | | | |
| Cash and cash equivalents | \$ 3,157,188 | \$ 3,157,188 | \$ 3,157,188 | \$ - | \$ - | \$ 3,157,188 |
| Long-term debt: | | | | | | |
| 2013 bonds | 55,158,923 | 55,158,923 | - | 55,158,923 | - | - |
| Note payable | 123,150 | 123,150 | - | - | 123,150 | 123,150 |
| Construction retainage payable | 2,597,913 | 2,597,913 | - | - | 2,597,913 | 2,597,913 |

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

Assets at Fair Value as of December 31, 2017

| | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 | Total |
|---|----------------|---------------|---------------|--------------|---------|---------------|
| Reported at Fair Value | | | | | | |
| Assets without donor restrictions: | | | | | | |
| 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 assets without donor restrictions 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, 2018 and 2017

| | Assets and Liabilities 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 | | | | | | |
| 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 |
| Disclosed at Fair Value (restated) | | | | | | |
| 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 |
| 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, 2018 and 2017

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, 2018 and December 31, 2017:

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.

6. Property and Equipment

Property and equipment consist of the following at December 31:

| | <u>2018</u> | <u>2017</u> |
|--|----------------------|----------------------|
| Land | \$ 6,400,000 | \$ 6,400,000 |
| Land improvements | 633,313 | 629,213 |
| Buildings | 84,945,564 | 85,570,345 |
| Furnishings and equipment | <u>27,341,536</u> | <u>25,964,322</u> |
| | 119,320,413 | 118,563,880 |
| Less accumulated depreciation and amortization | <u>(71,907,443)</u> | <u>(65,646,651)</u> |
| | 47,412,970 | 52,917,229 |
| Construction in progress | <u>40,206,745</u> | <u>15,718,204</u> |
| Total | <u>\$ 87,619,715</u> | <u>\$ 68,635,433</u> |

Interest costs capitalized were \$475,953 and \$334,438 during 2018 and 2017, respectively.

Fellowship Senior Living, Inc.

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December 31, 2018 and 2017

During 2010, FSL entered into an agreement for the renovation of the dining facilities. Under the agreement, FSL was advanced \$1,300,000 for the renovation project. FSL is required to repay \$650,000, which is included in long-term debt as a note payable. Effective April 1, 2018, FSL extended the term of this agreement and expanded the contract to include management services for plant operations and maintenance, housekeeping, laundry and security services. FSL was advanced an additional \$1,000,000 during 2018 for the new dining areas within the Health Center households which was recorded as deferred revenue to be amortized over the contract period. The amortization period for the balances remaining on the 2010 loan and advance was also extended for the term of the new contract. The note payable was \$123,150 and \$149,779 at December 31, 2018 and December 31, 2017, respectively. The portion of the advance which is not required to be repaid is recorded as deferred revenue of \$1,090,013 and \$150,000 at December 31, 2018 and December 31, 2017, 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 is recorded as a long term liability and is also included in Construction in Progress. As of December 31, 2018 and 2017, the retainage payable is \$2,597,913 and \$658,502, respectively.

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, 2018 and 2017, the portion of depreciation expense that is classified as accelerated is \$2,537,126 and \$1,691,433, respectively.

7. Long-Term Debt

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

| | <u>2018</u> <u>(Restated)</u> | <u>2017</u> <u>(Restated)</u> |
|---|----------------------------------|----------------------------------|
| Series 2013B Public Finance Authority (the "Authority"), Revenue and Refunding Bonds due in varying installments through 2035 plus interest at 65% of the one-month LIBOR, plus 1.20%. The Bonds are collateralized by a mortgage, the assignment of leases and rent, and a security agreement. | \$ 37,100,022 | \$ 40,567,665 |
| Series 2013A Public Finance Authority (the "Authority"), Revenue and Refunding Bonds due in varying installments through 2035 plus interest at 65% of the one-month LIBOR, plus 1.20%. The Bonds are collateralized by a mortgage, the assignment of leases and rent, and a security agreement. | 18,058,901 | 4,068,376 |
| Construction retainage payable | 2,597,913 | 658,502 |
| Note payable, Morrison (interest free) | 123,150 | 149,779 |
| Total debt | 57,879,986 | 45,444,322 |
| Less: current portion | 3,600,245 | 3,534,210 |
| deferred financing costs | 1,142,297 | 1,267,755 |
| Total | <u>\$ 53,137,444</u> | <u>\$ 40,642,357</u> |

Fellowship Senior Living, Inc.

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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, 2018 and 2017, respectively, \$18,058,901 and \$4,068,376 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 1, 2010, FSL entered into an interest free note payable of \$650,000 for the renovation of FSL's dining area. The note will be repaid monthly until 2028.

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 on the 2013B Bonds to fixed interest rates. In connection with an amendment to the Bond Agreement for the Series 2013 Bonds in December 2016, these agreements were terminated and new agreements were entered into. Under the terms of the new interest rate swap agreements, FSL pays fixed interest rates of 3.393% and 3.385%, respectively, on a quarterly basis and receives amounts equal to the notional amounts under the agreements multiplied by 65% of the one month LIBOR, plus 120 basis points, also on a quarterly basis. The total notional amounts under the agreements corresponds to the outstanding principal balance of the Series 2013B Bonds.

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

| | <u>Note Payable</u> | <u>2013 Bonds</u> | <u>Construction Retainage</u> | <u>Total</u> |
|------------|---------------------|----------------------|-------------------------------|----------------------|
| 2019 | \$ 13,315 | \$ 3,586,930 | \$ - | \$ 3,600,245 |
| 2020 | 13,314 | 3,710,321 | 2,597,913 | 6,321,548 |
| 2021 | 13,314 | 4,611,461 | - | 4,624,775 |
| 2022 | 13,314 | 4,765,904 | - | 4,779,218 |
| 2023 | 13,314 | 4,925,661 | - | 4,938,975 |
| Thereafter | 56,579 | 33,558,646 | - | 33,615,225 |
| Total | <u>\$ 123,150</u> | <u>\$ 55,158,923</u> | <u>\$ 2,597,913</u> | <u>\$ 57,879,986</u> |

8. Net Assets with Donor Restrictions

Net assets with donor restrictions consist of the following at December 31:

| | <u>2018</u> | <u>2017</u> |
|----------------------------|---------------------|---------------------|
| Capital Fund | \$ 1,046,362 | \$ 779,851 |
| Resident's Benevolent Fund | 234,863 | 278,999 |
| Community Renewal Fund | 11,726 | 13,074 |
| Legacy Endowment Fund | 805,424 | 888,670 |
| Total | <u>\$ 2,098,375</u> | <u>\$ 1,960,594</u> |

Fellowship Senior Living, Inc.

Notes to Financial Statements

December 31, 2018 and 2017

9. Functional Expenses

FSL provides residential and health care services to residents and other patients within its geographic location. The financial statements report certain expense categories that are attributable to more than one program service or support function. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including depreciation and amortization, interest, and other costs, are allocated to general and administrative. Other costs relating to specific functions, including plant operations and maintenance, grounds and security are allocated based on statistics related to total meals served. For the year ended December 31, 2018, expenses relating to providing these services are approximately as follows (restated):

| | <u>Resident Services</u> | <u>Health Care Services</u> | <u>Home Community Based Services</u> | <u>General and Administrative</u> | <u>Total</u> |
|--------------------------------|--------------------------|-----------------------------|--------------------------------------|-----------------------------------|----------------------|
| Salaries and benefits | \$ 1,669,718 | \$ 7,863,456 | \$ 6,302,354 | \$ 4,671,602 | \$ 20,507,130 |
| Contracted services | 2,688,575 | 1,780,829 | 134,712 | 838,387 | 5,442,503 |
| Supplies and other | 2,588,836 | 1,922,463 | 486,873 | 2,803,962 | 7,802,134 |
| Depreciation | - | - | - | 6,724,979 | 6,724,979 |
| Interest and amortization, net | - | - | - | 907,521 | 907,521 |
| Provision for bad debt | - | - | - | 94,268 | 94,268 |
| Total | <u>\$ 6,947,129</u> | <u>\$ 11,566,748</u> | <u>\$ 6,923,939</u> | <u>\$ 16,040,719</u> | <u>\$ 41,478,535</u> |

For the year ended December 31, 2017, expenses relating to providing these services are approximately as follows (restated):

| | |
|---|----------------------|
| Resident services | \$ 5,443,721 |
| Health care services | 12,166,840 |
| Home community based services | 6,150,878 |
| General and administrative (including interest and depreciation and amortization) | <u>14,477,327</u> |
| Total | <u>\$ 38,238,766</u> |

10. 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, 2018 and at December 31, 2017.

Fellowship Senior Living, Inc.

Notes to Financial Statements

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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.

11. 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 \$285,000 and \$308,100 for the twelve months ending December 31, 2018 and 2017, respectively.

12. 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.