# HumanGood National Obligated Group (HumanGood Arizona, dba Terraces of Phoenix, and HumanGood Washington, dba Judson Park) (Members of HumanGood Cornerstone)

Combined Financial Statements
and Supplementary Information

December 31, 2018

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## HumanGood National Obligated Group
## (HumanGood Arizona, dba Terraces of Phoenix,
## and HumanGood Washington, dba Judson Park)
## (Members of HumanGood Cornerstone)

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December 31, 2018

## Independent Auditors' Report

To the Members of the Board of Directors
HumanGood National Obligated Group
(HumanGood Arizona, dba Terraces of Phoenix,
and HumanGood Washington, dba Judson Park)
(Members of HumanGood Cornerstone)

### Report on the Combined Financial Statements

We have audited the accompanying combined financial statements of the HumanGood National Obligated Group ("National Obligated Group" or "NOG"), which comprise the combined balance sheet as of December 31, 2018, and the related combined statement of operations and changes in net deficit, and cash flows for the year then ended, and the related notes to the combined financial statements.

### Management's Responsibility for the Combined 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 combined 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of the National Obligated Group as of December 31, 2018 and the results of their operations and changes in net deficit, and cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

**Change in Reporting Entity**

During 2017, HumanGood Washington and HumanGood Arizona prepared separate standalone financial statements. Additional debt was issued in April 2018 (Note 6). As of the date of issuance of the additional debt, a Second and Amended Restated Master Indenture Trust was executed admitting HumanGood Washington into the National Obligated Group. Prior to HumanGood Washington's admission to the National Obligated Group, HumanGood Arizona was the sole member of the National Obligated Group.

**Other Matter, Report on Supplementary Information**

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The supplementary information is presented for the purpose of additional analysis and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the combined financial statements as a whole.

**Intended Use**

Our report is intended solely for the information and use of the boards of directors and management of the HumanGood National Obligated Group, the Master Trustee under the Master Trust Indenture, and other parties as required under the related Master Continuing Disclosure Agreement. It is not intended to be and should not be used by anyone other than these specified parties.

Baker Tilly Virchow Krause, LLP

Philadelphia, Pennsylvania
April 30, 2019

**HumanGood National Obligated Group**
**(HumanGood Arizona, dba Terraces of Phoenix,**
**and HumanGood Washington, dba Judson Park)**
**(Members of HumanGood Cornerstone)**

Combined Balance Sheet
(In Thousands)
December 31, 2018

| | | |
|---|---|---|
| **Assets** | | |
| **Cash and Cash Equivalents** | $ | 10,956 |
| **Resident Accounts and Other Receivables, Less Allowance for Doubtful Accounts of $234** | | 2,503 |
| **Investments** | | 19,724 |
| **Restricted Investments** | | 3,266 |
| **Prepaid Expenses, Deposits and Other Assets** | | 433 |
| **Land, Building, and Equipment, Net** | | 72,853 |
| Total assets | $ | 109,735 |
| **Liabilities and Net Deficit** | | |
| **Accounts Payable and Accrued Expenses** | $ | 2,483 |
| **Payable to Affiliates** | | 4,897 |
| **Deposits** | | 161 |
| **Accrued Interest** | | 1,003 |
| **Notes and Bonds Payable** | | 72,067 |
| **Subordinated Notes Payable to HumanGood NorCal** | | 12,000 |
| **Rebatable Entrance Fees Due** | | 57,709 |
| **Entrance Fees Subject to Refund** | | 4,316 |
| **Entrance Fees Non-Refundable** | | 15,711 |
| **Other Liabilities** | | 204 |
| Total liabilities | | 170,551 |
| **Net Deficit Without Donor Restriction** | | (60,816) |
| Total liabilities and net deficit | $ | 109,735 |

*See notes to combined financial statements*

**HumanGood National Obligated Group**
**(HumanGood Arizona, dba Terraces of Phoenix,**
**and HumanGood Washington, dba Judson Park)**
**(Members of HumanGood Cornerstone)**

Combined Statement of Operations and Changes in Net Deficit
(In Thousands)
December 31, 2018

| | |
|---|---|
| **Operating Revenues** | |
| Residential living | $ 16,506 |
| Assisted living | 5,893 |
| Health center | 16,714 |
| Memory support | 3,180 |
| Other residential services | 683 |
| Amortization of entrance fees | 3,837 |
| Other operating revenue | 958 |
| Total operating revenues | 47,771 |
| **Operating Expenses** | |
| Salaries and wages | 19,249 |
| Employee benefits | 4,170 |
| Supplies | 3,873 |
| Ancillary services | 2,958 |
| Repairs and maintenance | 470 |
| Marketing and advertising | 708 |
| Purchased services | 1,812 |
| Management fees | 3,482 |
| Utilities | 1,870 |
| Travel and related | 212 |
| Leases and rents | 284 |
| Insurance | 598 |
| Other operating expenses | 342 |
| Total operating expenses | 40,028 |
| **Income Before Other Operating Income (Expense)** | 7,743 |
| **Other Operating Income (Expense)** | |
| Investment income, net | 413 |
| Mortgage interest | (2,938) |
| Depreciation and amortization | (4,884) |
| Loss on early retirement of debt | (523) |
| Loss from operations | (189) |
| Change in fair value of interest rate swap and cap | 339 |
| Unrealized losses on investments, net | (223) |
| Change in net deficit | (73) |
| **Beginning Net Deficit As Previously Reported** | (51,544) |
| **Adjustments for Adoption of Accounting Pronouncement** | (274) |
| **Adjustments for Admission of HumanGood Washington to the National Obligated Group** | (8,925) |
| **Beginning Net Deficit As Adjusted for Change in Reporting Entity and Adoption of Accounting Pronouncement** | (60,743) |
| **Net Deficit, End of Year** | $ (60,816) |

*See notes to combined financial statements*

**HumanGood National Obligated Group**
**(HumanGood Arizona, dba Terraces of Phoenix,**
**and HumanGood Washington, dba Judson Park)**
**(Members of HumanGood Cornerstone)**

Combined Statement of Cash Flows
(In Thousands)
December 31, 2018

| | | |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Cash received from resident services | $ | 41,885 |
| Cash received from non-rebatable entrance fees from reoccupancy | | 3,157 |
| Cash provided by other operating activities | | 1,652 |
| Cash earnings realized from investments | | 410 |
| Cash paid for other employees salaries | | (17,630) |
| Cash paid for employees benefits | | (4,147) |
| Cash paid for temporary labor | | (1,853) |
| Cash paid to vendors | | (17,360) |
| Cash paid for interest | | (2,634) |
| Net cash provided by operating activities | | 3,480 |
| **Cash Flows from Investing Activities** | | |
| Acquisition of land, buildings, and equipment, | | (2,054) |
| Purchase of unrestricted investments | | (2,847) |
| Proceeds from sale of unrestricted investments | | 2,432 |
| Purchase of restricted investments | | (2,986) |
| Net cash used in investing activities | | (5,455) |
| **Cash Flows from Financing Activities** | | |
| Proceeds from rebatable entrance fees | | 5,098 |
| Refunds of deposits and refundable entrance fees | | (5,806) |
| Cash paid for deferred debt issuance costs | | (1,789) |
| Cash paid to affiliates | | (5,535) |
| Principal payments on notes and bonds payable | | (848) |
| Proceeds from issuance of notes and bonds payable | | 11,175 |
| Net cash provided by financing activities | | 2,295 |
| Increase in cash and cash equivalents | | 320 |
| **Cash and Cash Equivalents, Beginning of Year** | | 10,636 |
| **Cash and Cash Equivalents, End of Year** | $ | 10,956 |
| **Cash Flows from Operating Activities** | | |
| Change in net deficit | $ | (73) |
| Adjustments to reconcile change in net deficit to net cash provided by operating activities: | | |
| Amortization of entrance fees | | (3,837) |
| Proceeds from non-rebatable entrance fees from reoccupancy | | 3,157 |
| Depreciation and amortization | | 4,884 |
| Unrealized losses on investments | | 223 |
| Loss on early retirement of debt | | 523 |
| Change in fair value of interest rate swap and cap | | (339) |
| Change in residents accounts receivable and other receivable | | (199) |
| Change in prepaids, deposits and other assets | | 182 |
| Other changes in operating assets and liabilities, net | | (1,041) |
| Net cash provided by operating activities | $ | 3,480 |
| **Noncash Disclosures** | | |
| Long-term debt repaid with proceeds from Series 2018 Bonds | $ | 62,516 |

*See notes to combined financial statements*

## 1. Business Organization

### HumanGood National Obligated Group

The HumanGood National Obligated Group ("NOG" or "Corporations") formed in 2018 under the terms of a Master Trust Indenture (Note 6) includes HumanGood Arizona and HumanGood Washington.

### HumanGood Arizona

HumanGood Arizona (dba “Terraces of Phoenix” or "TOP") is an Arizona nonprofit public benefit tax-exempt corporation providing housing, health care, and supportive services for the elderly in Phoenix, Arizona through its continuing care retirement community ("CCRC"), Terraces of Phoenix. HumanGood NorCal (“NorCal”) has managed TOP since 1971, and from 1998 through September 29, 2003, NorCal was the sole corporate member of TOP. Since September 29, 2003, NorCal has continued to manage TOP under a multiyear management agreement. The funds previously advanced by NorCal to support TOP's operating and capital needs were retained in the form of a subordinated note payable from TOP to NorCal. Based on Terraces of Phoenix's projected cash flows, payments on the note receivable are not anticipated to begin until 2030.

The Terraces of Phoenix is located on a 21-acre campus in Phoenix, Arizona, and currently consists of 209 residential living apartments, 49 assisted living apartments, 25 memory support apartments, and a 64-bed skilled nursing facility with 36 private and 28 semi-private rooms. TOP was founded in 1963 with the mission of providing a full continuum of retirement living services to the elderly in the greater Phoenix area.

On December 15, 2015, in conjunction with a 2015 replacement financing, NorCal, in addition to providing $3.5 million of maximum recourse credit support in the event of default on bonded indebtedness, lent $11 million to TOP on a subordinated basis at 4.0% fixed interest, with $9 million used to fund a partial paydown of existing TOP primary debt, and the remainder used for liquidity and to fund debt issuance costs (See Note 6).

On May 24, 2018, concurrent with the formation of an obligated group consisting of TOP and Judson Park, pursuant to the terms of the master trust indenture issued in conjunction with the financing of $72,646,000 of bank and publicly issued notes, TOP refinanced its Series 2015 notes and fully repaid to NorCal its $11 million subordinated notes. Simultaneous with the closure of the financing, the TOP management agreement with NorCal was amended and restated such that the management fee was increased from 6% of actual cash revenues to 8.5% of total budgeted cash revenues, with half of this amount subject to subordination upon noncompliance with certain covenants. This amended and restated agreement renews automatically annually unless terminated with 60 days prior written notice.

### HumanGood Washington

HumanGood Washington (dba "Judson Park" or "JP") is a Washington nonprofit public benefit tax-exempt corporation providing housing, health care, and supportive services for the elderly in Washington through its CCRC, Judson Park. NorCal has managed JP since 1975. The management agreement with NorCal calls for a management fee of 8.5% of total budgeted cash revenues. This agreement renews automatically annually unless terminated with 60 day prior notice.

Judson Park is located on a 10-acre campus in Des Moines, Washington, and consists of 167 residential living apartments, 31 assisted living apartments, 16 memory support apartments, and a 94-bed skilled nursing facility with 24 private and 70 semi-private rooms. The campus opened in 1963 with the mission of providing a full continuum of retirement living services to the elderly in the greater Seattle metro area.

On May 24, 2018, as part of the aforementioned financing of $72,646,000 of bank and publicly issued notes, JP refinanced its Series 2012 notes and borrowed an additional $9 million to fund the repayment of outstanding intercompany advances owing to NorCal (See Note 6).

**Parent Organization**

HumanGood Cornerstone, a California nonprofit public benefit tax-exempt corporation, is the sole member and exercises its direction and control through the appointment of the Board of Directors of HumanGood Arizona (formerly American Baptist Estates, Inc., dba "Terraces of Phoenix"), HumanGood Washington (formerly American Baptist Homes of Washington, dba Judson Park), HumanGood Nevada (formerly Las Ventanas Retirement Community dba "Las Ventanas"), HumanGood Idaho (formerly Boise Retirement Community, dba The Terraces of Boise, "Boise"), and HumanGood Properties (formerly Seniority Properties). HumanGood and Cornerstone's Boards are composed of the same seven directors.

HumanGood is a California nonprofit public benefit tax-exempt corporation. HumanGood is the sole member of HumanGood Fresno (dba Terraces at San Joaquin Gardens, "TSJG"), HumanGood Cornerstone ("Cornerstone"), HumanGood SoCal ("SoCal", formerly Southern California Presbyterian Homes), Redwood Senior Homes and Services ("RSHS"), Westminster Gardens, and HumanGood NorCal ("NorCal", formerly American Baptist Homes of the West). NorCal is the sole member of HumanGood Foundation West ("Foundation West", formerly American Baptist Homes Foundation of the West, Inc.) and SoCal is the sole member of HumanGood Foundation South ("Foundation South", formerly Southern California Presbyterian Homes Foundation).

**Cornerstone Related Enterprises**

**HumanGood Nevada**

HumanGood Nevada (dba Las Ventanas) is a California nonprofit public benefit tax-exempt corporation providing housing, health care, and supportive services for the elderly in the Las Vegas, Nevada area through its CCRC.

**HumanGood Idaho**

HumanGood Idaho (dba Terraces of Boise or "Boise") is a California nonprofit public benefit tax-exempt corporation providing housing, health care, and supportive services for the elderly in Boise, Idaho through its CCRC.

**HumanGood Properties**

HumanGood Properties is a California for-profit corporation, which was formed in February 2014 for the purpose of holding equity interests in, developed and acquired free-standing senior housing communities and other similar investments.

### Other Parent Related Enterprises

#### HumanGood NorCal

HumanGood NorCal ("NorCal") is a California nonprofit public benefit tax-exempt corporation that owns, operates, and manages both CCRCs and rental housing communities in which housing, health care, and supportive services are provided for the elderly in California, Nevada, Arizona and Washington. NorCal provides TOP and JP financial support and management services, including financial budgeting, accounting, and tax services; negotiation of capital and financing services; regulatory and compliance oversight and legal support; a pooled program for employee benefits including pensions; and a pooled program for property and liability insurance as well as other services through NorCal affiliates. TOP and JP reimburse NorCal for their pro-rata share of employee benefit costs.

#### HumanGood SoCal

HumanGood SoCal ("SoCal", formerly Southern California Presbyterian Homes) is a California nonprofit public benefit tax-exempt corporation which owns, operates and manages CCRCs and rental housing communities, primarily in Southern California, in which housing, health care, and supportive services are provided for the elderly. SCPH includes four CCRCs (Royal Oaks, White Sands, Windsor, and Regents Point) together with its controlled affiliates, Redwood Senior Homes and Services and Westminster Gardens.

#### HumanGood Fresno

HumanGood Fresno (dba Terraces at San Joaquin Gardens) is a California nonprofit public benefit tax-exempt corporation providing housing, health care, and supportive services for the elderly in Fresno, California, through its CCRC.

#### HumanGood Foundation West

HumanGood Foundation West ("Foundation West") is a California nonprofit public benefit tax-exempt corporation whose primary purpose is to develop, invest, and administer funds to provide residential and nursing home care on behalf of the residents of certain communities of HumanGood, including TOP and JP. Foundation West's principal activity is to administer such funds under trust agreements. NorCal is the sole member of Foundation West, and therefore, elects the directors of Foundation West. As a result, NorCal has control over Foundation West, and therefore, Foundation West is included in NorCal's special-purpose combined financial statements. Foundation West guarantees the bond obligations of NorCal. Foundation West's obligations under the guaranty agreement are limited to Foundation West's income earned on its unrestricted net assets.

#### HumanGood Foundation South

HumanGood Foundation South ("Foundation South") is a California nonprofit public benefit tax-exempt corporation whose primary purpose is to develop, invest, and administer funds to provide residential and nursing home care on behalf of the SoCal residents. The Foundation South's principal activity is to administer such funds under trust agreements. SoCal is the sole member of Foundation South, and therefore, elects the directors of Foundation South. As a result, SoCal has control over Foundation South, and therefore Foundation South is included in SoCal's special-purpose combined financial statements.

### Basis of Presentation and Principles of Combination

The Corporations prepare combined financial statements in accordance with the financial reporting provisions specified in the disclosure requirements of the Master Trust Indenture. The Master Trust Indenture specifies the preparation of combined financial statements of the Obligated Group members; accordingly, the accompanying combined financial statements include only the accounts of the National Obligated Group members, which is in conformity with generally accepted accounting principles ("GAAP") in the United States of America.

All inter-affiliate transactions between the Corporations have been eliminated in combination.

### Change in Reporting Entity

During 2017 HumanGood Washington and HumanGood Arizona prepared separate standalone financial statements. Additional debt was issued in May 2018 (Note 6). As of the date of issuance of the additional debt, a Second and Amended Restated Master Indenture Trust was executed admitting HumanGood Washington to the Obligated Group. Prior to HumanGood Washington's admission into the Obligated Group, HumanGood Arizona was the sole member of the Obligated Group. Loss from operations was decreased from ($746,000) to $189,000 as a result of the admission of HumanGood Washington to the Obligated Group.

## 2. Summary of Significant Accounting Policies

### Use of Estimates

The preparation of the combined financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and reported amounts of revenues and expenses during the reported periods. Significant items subject to such estimates and assumptions include the fair value of interest rate swap; allowances for contractual and uncollectible accounts receivable; fair value of investments; future service benefit obligation; rebatable entrance fees due; entrance fees subject to refund; and entrance fees non-refundable. Actual results could differ from those estimates.

### Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand, demand deposits with financial institutions, and overnight investments considered to be cash equivalents.

### Investments

Investments include certain cash equivalents held by investment managers, domestic corporate debt securities, mutual funds, municipal bonds and U.S. government securities. Investments are measured at fair value in the accompanying combined balance sheet.

Investment income (including realized gains and losses on investments, interest, and dividends) is included in the accompanying combined statement of operations and changes in net assets without donor restrictions. Historical cost, on the specific identification method, is utilized to compute the realized gains and losses for securities. Upon determination that the cost of securities is other-than-temporarily impaired, adjustments are made to revalue the securities to current value. Any adjustments required by this policy for unrestricted assets are charged to investment loss. Unrealized gains and losses are recorded in other changes in net assets without donor restrictions.

**Restricted Investments**

Restricted investments include assets held by trustees in accordance with the indentures related to the debt agreement. Restricted investments include certain cash and cash equivalents.

**Resident Accounts Receivable**

The Corporations assess collectability on all resident accounts prior to providing services. An allowance for uncollectible accounts is recognized to reduce accounts receivable to its net realizable value for impairment of revenues for changes in resident credit worthiness. The allowance is estimated by management based on factors such as aging of the accounts receivable (outstanding balances over 150 days are fully reserved), and anticipated collection of the consideration. Accounts are written off through bad debt expense when the Corporations have exhausted all collection efforts and accounts are deemed impaired.

**Land, Buildings, and Equipment**

Land, buildings, and equipment are recorded at cost, or fair value when received, if donated. The cost basis includes any interest, finance charges, and other related costs capitalized during construction. Maintenance and repair costs are charged to operations when incurred.

Depreciation of buildings and equipment is computed on the straight-line method using estimated useful lives of 3 to 40 years. When assets are retired or otherwise disposed of, the cost of the asset and its related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

**Asset Impairment**

The Corporations periodically evaluate the carrying value of their long-lived assets for impairment. The evaluations address the estimated recoverability of the assets' carrying value, which is principally determined based on projected undiscounted cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds estimated recoverability, an asset impairment is recognized. No asset impairment was recognized at December 31, 2018.

**Fair Value of Financial Instruments**

Unless otherwise indicated, the fair value of all reported assets and liabilities that represent financial instruments approximate their carrying values. The Corporations' policy is to recognize transfers in and transfers out of Level 1 and Level 2 at the end of the reporting period. See Note 4 for fair value hierarchy disclosures.

### Deferred Debt Issuance Costs

Expenses incurred in connection with the issuance of debt are deferred and are amortized over the term of the related financing agreements using the interest method are presented in the combined balance sheets as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Amortization is included as a component of interest expense. Unamortized deferred debt issuance costs amounted to $2,041,000 at December 31, 2018. Accumulated amortization of deferred debt issuance costs was $161,000 at December 31, 2018.

### Obligation to Provide Future Services

If the present value of future outflows to provide future services, adjusted for certain noncash items, exceeds the present value of future cash in-flows, a liability is recognized. An evaluation of the future service benefit obligation for residents indicated that a liability was not considered necessary at December 31, 2018. The discount rate used to calculate the obligation to provide future services was 7% for 2018.

### Types of Entrance Fees

The Care and Residence Agreements between the Corporations and their residents provide for the payment of an entrance fee. Entrance fees received by the Corporations are categorized into two types: initial entrance fees and entrance fees from reoccupancy, which are recorded as either rebatable entrance fees due, entrance fees subject to refund, or entrance fees non-refundable in the accompanying combined balance sheet. Initial entrance fees, which are the initial fees on new or expanded facilities, are used to provide funds for acquisition and construction of physical facilities, debt retirement, and to defray anticipated deficits in the operations of new homes for a period of time. Entrance fees from reoccupancy in existing homes are used for general purposes, including capital expenditures, support of operations (including benevolence), and funding of reserves.

### Refund Policy on Entrance Fees

The Care and Residence Agreement provides the resident with the right to a refund of the entrance fee, less 2.0% for each month of residency for 44 months after an initial reduction to the original fee, under certain circumstances. In certain cases, upon the move out of a resident, the unamortized balance of the entrance fee on a contractual basis is payable to the resident.

The Corporations have offered contract options whereby 50% to 100% of the entrance fee is rebatable at death or termination of the contract and subsequent re-occupancy of the apartment. At December 31, 2018, $57,709,000 of the entrance fees related to these types of contracts are contractually rebatable, and are presented as rebatable entrance fees due in the accompanying combined balance sheet. Included in these amounts are $1,297,000 in entrance fee rebates due pending apartment re-occupancy, $1,358,000 in entrance fee rebates due pending the move-out of residents in higher levels of care and re-occupancy of their apartment, and $6,567,000 in entrance fee rebates due pending only the move-out of residents currently residing in higher levels of care at December 31, 2018.

At December 31, 2018, the Corporations had non-refundable entrance fees of $15,711,000 related to entrance fees received that will be recognized as revenue in future years. Additionally, at December 31, 2018, the Corporations had entrance fees subject to refund of $4,316,000, which will be recognized as revenue in future years, unless refunded.

Actual refunds and rebates of entrance fees were $5,806,000 for the year ended December 31, 2018. Based on historical experience, management expects to pay refunds in future years of approximately $7,347,000 per year.

### Interest Rate Cap and Swap

The Corporations have utilized interest rate swaps and caps as part of its overall debt management policy. The Corporations account for the interest rate cap and swap in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") *Topic 815, Derivatives and Hedging*. The topic requires that all derivatives be carried at fair value on the combined balance sheet. Changes in the fair value of derivatives were recorded each period as a change in net deficit (see Note 7).

### Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor imposed restrictions. All net assets as of December 31, 2018 are classified as net assets without donor restrictions as they are not subject to donor or time restrictions and are available for use in general operations. No assets with donor imposed restrictions, temporary or perpetual in nature, are held as of December 31, 2018.

### Contributions

The Corporations participate in the HumanGood Foundation West fundraising activity. Gifts and bequests to the Corporations are credited to the Corporations' funds with Foundation West. In addition, upon maturity, deferred gifts such as gift annuities and charitable remainder trusts are also credited to the Corporations' funds. Funds held by Foundation West that the Foundation West board has designated for the Corporations amount to approximately $4,988,000 of board designated funds, and $151,000 of donor restricted project funds at December 31, 2018. Foundation West retains a legal right to redirect the use of these unrestricted funds. Board practice since inception has been to designate earnings distributions on funds for community benevolence needs. The Corporations receive distributions from Foundation West based upon the market value of the twelve-quarter rolling average of the Corporations' board designated funds at a current rate of 3.5%. This rate is subject to change based upon the Foundation West board's action. Included in the accompanying statement of operations and changes in net deficit is $155,000 for the year ended December 31, 2018 of distribution income from Foundation West.

### Net Resident Service Revenues

Net resident service revenues are reported at the amount that reflects the consideration the Corporations expect to receive in exchange for the services provided. These amounts are due from residents or third-party payors and include variable consideration for retroactive adjustments, if any, under reimbursement programs. Performance obligations are determined based on the nature of the services provided. Net resident service revenues are recognized as performance obligations are satisfied.

Payment terms and conditions for the Corporations' resident contracts vary by contract type and payor source, although terms generally include payment to be made within 30 days. Net resident service fee revenues for recurring and routine monthly services are generally billed monthly in advance. Net resident service fee revenues for ancillary services are generally billed monthly in arrears. Additionally, entrance fees are generally billed and collected in advance of move-in, and are recognized as deferred revenue from entrance fees until the performance obligations are satisfied and are included in deferred revenues from entrance fees in the accompanying combined balance sheet. The Corporations recognized amortization income of $3,837,000 in 2018. The Corporations apply the practical expedient in ASC 606 and therefore do not disclose amounts for remaining performance obligations that have original expected durations of one year or less.

The guaranteed refund component of entrance fees is not amortized to income and is classified as rebatable entrance fees due in the accompanying combined balance sheet.

For residents with Type B contracts, revenue from entrance fees other than rebatable entrance fees received are recognized through amortization using the straight-line method over annually adjusted estimated remaining life expectancies of the residents, which approximates the period of time the goods and services under the agreements are expected to be transferred to residents. Amortization of entrance fees other than rebatable entrance fees is included as amortization of entrance fees in the statement of operations and changes in net assets.

Net resident service revenues are primarily comprised of the following revenue streams:

**Health Center**

Health center revenues are primarily derived from providing nursing services to residents at a stated daily fee, net of any explicit and implicit price concessions. The Corporations have determined that health center services are considered one performance obligation, which is satisfied over time as services are provided. Therefore, health center revenues are recognized on a daily basis as services are rendered.

Health Center revenues, including monthly service fees, ancillary, and other service fees are reported at the estimated net realizable amounts from residents, third party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors.

The Corporations receive revenue for services under third-party payor programs, including Medicare, Medicaid and other third-party payors. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence with the payor and the Corporations' historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, as new information becomes available), or as years are settled or no longer subject to such audits, reviews and investigations. Adjustments arising from a change in the transaction price, were not significant in 2018.

#### Assisted Living and Memory Support

Assisted living and memory support revenues are primarily derived from providing housing and personal care services to residents at a stated monthly fee. The Corporations have determined that the services included in the monthly fee have the same timing and pattern of transfer and are a series of distinct services that are considered one performance obligation for each of these levels of care, which is satisfied over time as services are provided. Therefore, assisted living and memory support revenues are recognized on a month-to-month basis.

#### Residential Living

Residential living revenues are primarily derived from providing housing and services to residents. The Corporations have determined that the services included in the monthly fee have the same timing and pattern of transfer and are a series of distinct services that are considered one performance obligation, which is satisfied over time as services are provided. Therefore, residential living monthly fees are recognized on a month-to-month basis.

### Benevolence

The Corporations provide services to residents who meet certain criteria under their benevolence policy without charge or at amounts less than its established rates. Because the Corporations do not normally pursue collection of amounts determined to qualify as benevolence, they are not reported as revenues. For the year ended December 31, 2018, the cost of benevolence amounted to $433,000. Additionally, the Corporations utilized reductions to the rebatable portion of certain residents' entry fees to satisfy unpaid monthly service fees. The total amount of these reductions was $247,000 for the year ended December 31, 2018.

### Contractual Allowances

A portion of the Corporations' revenues is subject to explicit price concessions under contracts with third-party payors. These price concessions, reported as contractual allowances, were $3,827,000 for the year ended December 31, 2018.

### Performance Indicator

Income from operations as reflected in the accompanying combined statement of operations and changes in net deficit is the performance indicator. Income from operations includes all changes in unrestricted net deficit other than noncash changes in unrealized losses on investments, and changes in the fair value of interest rate cap and swap agreements.

### Workers' Compensation Plan

HumanGood Arizona participates in the State of Arizona's fully insured workers' compensation program and HumanGood Washington participates in the State of Washington's fully insured workers' compensation program. Both corporations receive safety program support from NorCal. The Corporations' expenses for these coverages are reflected as a component of the benefit burden applied to payroll. Amounts charged to the Corporations for their workers' compensation programs was $446,000 for the year ended December 31, 2018.

### Professional Liability Insurance

The Corporations have professional liability insurance through a pooled program provided by HumanGood. HumanGood has secured claims-made policies for malpractice and general liability insurance with a self-insured retention of $100,000 for the year ended December 31, 2018. At December 31, 2018, the Corporations had a remaining liability of approximately $50,000 as their best estimate of the cost of known claims and claims incurred but not reported. The liability is included in accounts payable and accrued expenses on the accompanying combined balance sheet.

### Tax-Exempt Status

HumanGood Arizona is an Arizona nonprofit public benefit tax-exempt corporation as described in Section 501(c)(3) of the Internal Revenue Code ("IRC") and has been granted tax-exempt status by the Internal Revenue Service ("IRS") and the Arizona Department of Revenue. HumanGood Washington is a Washington nonprofit public benefit tax-exempt corporation as described in Section 501(c)(3) of the IRC and has been granted tax-exempt status by the IRS and the Washington State Department of Revenue.

The Corporations assess uncertain tax positions in accordance with the provisions of the FASB ASC *Topic 740-10, Income Taxes.* The Corporations recognize the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Corporations recognize interest and penalties related to income tax matters in operating expenses. At December 31, 2018, there were no such uncertain tax positions.

### New Accounting Pronouncements

In 2018, the Corporations adopted the FASB Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* using the modified retrospective approach. ASU No. 2014-09 supersedes the revenue recognition requirements in *Topic 605, Revenue Recognition*, and most industry specific guidance. The core principle under ASU No. 2014-09 is that revenues are recognized to depict the transfer of promised goods or services to customers (residents) in an amount that reflects the consideration at which the entity expects to be entitled in exchange for those goods or services. Additionally, ASU No. 2014-09 requires enhanced disclosures of revenue arrangements. Under the modified retrospective approach, the guidance is applied to the most current period presented, recognizing a cumulative effect of the adoption change as an adjustment to beginning unrestricted net assets. The Corporations have determined that there will be a change to deferred marketing costs related to the accounting for contract acquisition costs under ASU No. 2014-09. As a result, there was a decrease of $274,000 in deferred marketing costs and unrestricted net assets as of January 1, 2018.

In 2018, the Corporations 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. The Corporations have adjusted the presentation of these financial statements accordingly.

The new standard is addressed in the following aspects of the combined financial statements:

- The unrestricted net assets class has been renamed Net Assets Without Donor Restrictions;
- Investment expenses are included in investment income, net
- The combined financial statements include a disclosure about liquidity and availability of resources at December 31, 2018 (Note 3).
- The functional expense disclosure for 2018 includes expenses reported both by nature and function (Note 10).

During November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. ASU 2016-18 is to be applied retroactively with transition provisions. The Corporations are currently assessing the impact ASU 2016-18 will have on its financial statements.

In 2016, FASB issued ASU No. 2016-01*, Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU No. 2016-01: a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (g) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (h) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU No. 2016-01 is effective for annual periods beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted as of fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Corporations early adopted the provision that eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost. The Corporations are currently assessing the impact the remaining provisions of ASU 2016-1 will have on its financial statements.

## 3. Liquidity and Availability of Resources

As of December 31, 2018, the Corporations have financial assets available for general expenditure within one year of the combined balance sheet date, which consist of the following (in thousands):

| | | |
|---|---|---|
| Cash and cash equivalents | $ | 10,956 |
| Accounts receivable and entrance fee receivables | | 2,503 |
| Investments | | 19,724 |
| Total | $ | 33,183 |

The Corporations' investments are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the quantitative information above.

As part of the Corporations' liquidity management plan, cash in excess of daily requirements are invested in short-term investments and money market funds. These funds may be drawn upon, if necessary, to meet unexpected liquidity needs.

## 4. Fair Value Measurements, Investments and Restricted Investments

FASB ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or net asset value per share (or its equivalent) with the ability to redeem the investments in the near term.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying combined financial statements, as well as the general classification of such instruments pursuant to the valuation hierarchy:

- Cash and cash equivalents - The carrying amount approximates fair value.

- Restricted investments - Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include cash and cash equivalents held for investment and mutual funds

- Investments (Mutual Funds) - Mutual funds registered with the Securities and Exchange Commission as mutual funds under the Investment Company Act of 1940 are valued based on quoted market prices, which represent the net asset value of shares, and are categorized as Level 1.

- Investments (Corporate Bonds) - Investment-grade bonds are valued using inputs and techniques which include third-party pricing vendors, dealer quotations, and recently executed transactions in securities of the issuer or comparable issuers. To the extent that these inputs are observable and timely, the values are categorized as Level 2.

- Investments (Municipal Bonds) - Municipal Bonds are valued using inputs and techniques which include identification of similar issues and market activity. To the extent that these inputs are observable and timely, values are categorized as Level 2.

- Investments (U.S. Government Securities) - U.S. Treasury securities are valued based on prices provided by third-party vendors that obtain feeds from a number of live data sources, including active market makers and interdealer brokers. To the extent that these inputs are observable and timely, values are categorized as Level 2.

- Interest Rate Cap Agreements - The fair value is estimated by a third party using inputs that are observable or that can be corroborated by observable market data and, therefore, are classified as Level 2.

The following table presents the fair value measurements of assets recognized in the accompanying combined balance sheet measured at fair value on a recurring basis and the level within the FASB ASC Topic 820 fair value hierarchy in which the fair value measurements fall at December 31 (in thousands):

| | Fair Value at December 31, 2018 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Investments: | | | | |
| Cash and equivalents | $ 2,229 | $ - | $ - | $ 2,229 |
| Mutual funds | 1,276 | - | - | 1,276 |
| Municipal bonds | - | 1,216 | - | 1,216 |
| Corporate bonds | - | 12,495 | - | 12,495 |
| U.S. government securities | - | 2,508 | - | 2,508 |
| Total investments | $ 3,505 | $ 16,219 | $ - | $ 19,724 |
| Restricted investments, | | | | |
| Cash and equivalents | $ 3,266 | $ - | $ - | $ 3,266 |
| Interest rate cap | $ - | $ 237 | $ - | $ 237 |

**Investment Return**

Investment return for the year ended December 31, 2018 is as follows (in thousands):

| | |
|---|---|
| Dividend, interest and other investment income | $ 439 |
| Net realized losses on investments | (26) |
| Total investment income, net | $ 413 |
| Unrealized losses on investments | $ (223) |

Investment income is net of investment expenses of $69,000 for the year ended December 31, 2018.

## 5. Land, Buildings, and Equipment

Land, buildings, and equipment at cost at December 31, 2018 consist of the following (in thousands):

| | |
|---|---|
| Land | $ 597 |
| Land improvements | 3,054 |
| Buildings and improvements | 119,684 |
| Furnishings, equipment and automotive | 9,324 |
| Total | 132,659 |
| Accumulated depreciation | (60,712) |
| Total | 71,947 |
| Construction in progress | 906 |
| Total | $ 72,853 |

Depreciation expense for the year ended December 31, 2018 was $4,884,000.

## 6. Notes and Bonds Payable

A summary of the Corporations' notes and bonds payable at December 31 is as follows (in thousands):

| | |
|---|---|
| Bonds used to refinance existing debt and renovate and redevelop the Corporations: | |
| Series 2018 tax-exempt Revenue Bonds issued by the Washington State Housing Finance Commission (dated May 24, 2018), annual principal payments commencing on July 1, 2019 in varying amounts ranging from $285 to 1,045 through July 1, 2048; interest rates ranging from 3.7% to 5.0%, payable semi-annually on each January 1 and July 1. | $ 17,015 |
| Series 2018A tax-exempt Revenue Bonds issued by the Industrial Development Authority of the City of Glendale, Arizona (dated May 24, 2018), annual principal payments commencing on July 1, 2019 in varying amounts ranging from $320 to 1,175 through July 1, 2048; interest rates ranging from 3.6% to 5.0%, payable semi-annually on each January 1 and July 1. | 19,130 |
| Series 2018B tax-exempt Revenue Bonds issued by the Industrial Development Authority of the City of Glendale, Arizona (dated May 24, 2018), the bonds mature on June 1, 2043; variable interest at a rate of 79% of 1-Mo LIBOR plus 1.75% with monthly principal and interest payments commencing July 1, 2018 through maturity. Rate at December 31, 2018 was approximately 3.74%. | 16,323 |
| Series 2018 taxable corporate loan issued by Washington Federal Bank (dated May 24, 2018), the bonds mature on June 1, 2043; variable interest at a rate of 1-Mo LIBOR plus 1.75% with monthly principal and interest payments commencing July 1, 2018 through maturity. Rate at December 31, 2018 was approximately 4.27%. | 19,819 |

| | |
|---|---|
| Related-Party Notes Payable: | |
| Subordinated note payable to NorCal. The note is unsecured and is subordinated to the lien in favor of the Series 2018 Bonds. The note is non-interest bearing and is payable from operating revenues based on the achievement of certain operating and liquidity covenants, estimated to begin in 2030. | $ 12,000 |
| Promissory Note: | |
| Promissory note to American Baptist Service Corporation ("ABSCO"), secured by deeds of trust. The note is non-interest bearing and is payable on a ratable basis with the NorCal subordinated note estimated to begin in 2030, or if not amortized, in a single payment due on January 28, 2028, or upon the sale of TOP. | 800 |
| | 85,087 |
| Plus: unamortized premium | 1,021 |
| Less: unamortized debt issuance cost | (2,041) |
| Total notes and bonds payable | $ 84,067 |

On December 15, 2015, TOP entered into a direct placement financing with Washington Federal Bank to replace its Series 2003 and Series 2007 bonds, which included a key provision that NorCal make advances of $11,000,000 in exchange for subordinated notes to TOP bearing interest at 4%. On May 24, 2018, in conjunction with the financing of $72,646,000 of bank and publicly issued notes, TOP refinanced its Series 2015 notes and fully repaid to NorCal its $11 million in subordinated notes, and JP refinanced its Series 2012 notes and borrowed an additional $9 million to fund repayment of existing intercompany operating advances outstanding. In conjunction with this transaction, the Corporations recorded a loss on early retirement of debt of $523,000 that is included in the combined statement of operations and changes in net deficit.

As of September 29, 2003, due to the transfer of sole membership of TOP from NorCal to Cornerstone, $12,000,000 of funds previously advanced by NorCal to support TOP's operating and capital needs were retained in the form of a note payable to NorCal from TOP. Based on TOP's projected cash flows, payments on the notes payable are not anticipated until 2030. Repayment of the note is subordinate to the 2018 bonded indebtedness.

Scheduled maturities of notes and bonds payable are as follows (in thousands):

| | |
|---|---|
| Years ending December 31: | |
| 2019 | $ 1,029 |
| 2020 | 1,415 |
| 2021 | 1,488 |
| 2022 | 1,552 |
| 2023 | 1,619 |
| Thereafter | 77,984 |
| Total | $ 85,087 |

The Corporations are subject to financial covenants on debt, which include a debt service coverage ratio and days cash on hand ratio.

## 7. Interest Rate Swap and Cap

In 2016, TOP entered into an interest rate cap agreement with Commonwealth Bank of Australia to manage interest rate risk on $18,700,000 of its Series 2015 bonds. The agreement establishes that when 70% of the one month LIBOR rate exceeds 2.5%, the Terraces of Phoenix is reimbursed for the excess by the counterparty to the transaction. The 10 year agreement expires in February 2026. The net effect of this interest rate cap was an increase in interest expense of approximately $41,000 for the year ended December 31, 2018.The change in the fair value of the interest rate cap for the year ended December 31, 2018 was an increase of $58,000.

On May 24, 2018, in conjunction with the $72.6 million financing, an existing Judson Park swap with a $10,753,000 notional amount was terminated concurrent with a $158,000 termination payment from JP to the swap counterparty. The net effect of this interest rate swap was an increase in interest expense of approximately $240,000 for the year ended December 31, 2018, inclusive of the termination payment.

## 8. Employee Benefit Plans

Effective January 1, 1999, NOG also participates in a defined contribution retirement plan covering all eligible employees with a corporate match of employee contributions up to 4% of eligible earnings.

## 9. Resident Services and Patient Revenues

The Corporations disaggregate revenue from contracts with customers by type of service and payor source as this depicts the nature, amount, timing and uncertainty of its revenue and cash flows as affected by economic factors. Resident services and patient revenues consist of the following for the year ended December 31, 2018 (in thousands):

| | 2018 | | | | |
|---|---|---|---|---|---|
| | **Residential Living** | **Assisted Living** | **Health Center** | **Memory Support** | **Total** |
| Private (contract) | $ 16,395 | $ 2,795 | $ 3,123 | $ 1,675 | $ 23,988 |
| Private (non-contract) | 111 | 3,098 | 2,082 | 1,505 | 6,796 |
| Medicare (Part A) | - | - | 5,571 | - | 5,571 |
| Medicare (Part B) | - | - | 289 | - | 289 |
| Medicaid | - | - | 3,136 | - | 3,136 |
| Managed care | - | - | 2,513 | - | 2,513 |
| Total payers | $ 16,506 | $ 5,893 | $ 16,714 | $ 3,180 | $ 42,293 |
| Amortization of non-rebatable entrance fees | | | | | $ 3,837 |

## 10. Functional Expenses

The Corporations provide housing, healthcare, and other related services to residents within their geographic location. The combined 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. Expenses relating to providing these services are approximately as follows (in thousands):

| | Residential Services | General and Administrative | Total |
|---|---|---|---|
| Salaries and wages | $ 18,099 | $ 1,150 | $ 19,249 |
| Employee benefits | 3,838 | 332 | 4,170 |
| Supplies | 3,804 | 69 | 3,873 |
| Ancillary services | 2,958 | - | 2,958 |
| Repair and maintenance | 470 | - | 470 |
| Marketing | 707 | 1 | 708 |
| Purchased services | 1,312 | 500 | 1,812 |
| Group management fees | - | 3,482 | 3,482 |
| Utilities | 1,691 | 179 | 1,870 |
| Travel and related | 171 | 41 | 212 |
| Rentals and leases | 152 | 132 | 284 |
| Insurance | 598 | - | 598 |
| Other operating expenses | 342 | - | 342 |
| Interest expense | 2,938 | - | 2,938 |
| Depreciation and amortization | 4,884 | - | 4,884 |
| Total expenses | $ 41,964 | $ 5,886 | $ 47,850 |

## 11. Transactions with Affiliates

Amounts payable to affiliates include management fees (described in Note 1) and cost recoveries for other services such as dining, purchase cards, payroll, and insurance payable to NorCal. The Corporations recognized expenses of $3,482,000 during 2018 that consisted of management fees and received distributions from Foundation West as described in Note 2. The Corporations owed NorCal $4,897,000 as of December 31, 2018.

## 12. Commitments and Contingencies

The Corporations are party to various claims and legal actions in the normal course of business. In the opinion of management, based upon current facts and circumstances, the resolution of these matters is not expected to have a material adverse effect on the financial position of the Corporations.

### 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 continues 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; however, the possible future effects of this matter on the Corporations, if any, are not presently determinable.

## 13. Concentrations of Credit Risk

The Corporations grant credit without collateral to their residents, some of whom are insured under third-party payor arrangements.

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

## 14. Subsequent Events

Subsequent events are events or transactions that occur after the combined balance sheet date but before the combined financial statements are issued. The Corporations recognize in the combined financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the combined balance sheet, including the estimates inherent in the process of preparing the combined financial statements. The Corporations' combined financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the combined balance sheet but arose after the combined balance sheet date and before combined financial statements are issued.

The Corporations have evaluated subsequent events through April 30, 2019, which is the date the combined financial statements were issued.

**HumanGood National Obligated Group**
**(HumanGood Arizona, dba Terraces of Phoenix,**
**and HumanGood Washington, dba Judson Park)**
**(Members of HumanGood Cornerstone)**

Combining Balance Sheet Schedule
(In Thousands)
December 31, 2018

| | Terraces of Phoenix | Judson Park | Total Combined |
|---|---|---|---|
| **Assets** | | | |
| **Cash and Cash Equivalents** | $ 5,270 | $ 5,686 | $ 10,956 |
| **Resident Accounts Receivable, Net Less Allowances for Doubtful Accounts of $49, and $185** | 886 | 1,617 | 2,503 |
| **Investments** | 12,194 | 7,530 | 19,724 |
| **Restricted Investments** | 1,753 | 1,513 | 3,266 |
| **Prepaid Expenses, Deposits and Other Assets** | 215 | 218 | 433 |
| **Land, Building, and Equipment, Net** | 44,361 | 28,492 | 72,853 |
| Total assets | $ 64,679 | $ 45,056 | $ 109,735 |
| **Liabilities and Net Deficits** | | | |
| **Accounts Payable and Accrued Expenses** | $ 1,347 | $ 1,136 | $ 2,483 |
| **Payable to Affiliates** | 1,724 | 3,173 | 4,897 |
| **Deposits** | - | 161 | 161 |
| **Accrued Interest** | 566 | 437 | 1,003 |
| **Notes and Bonds Payable** | 46,512 | 25,555 | 72,067 |
| **Subordinated Notes Payable to HumanGood NorCal** | 12,000 | - | 12,000 |
| **Rebatable Entrance Fees Due** | 48,195 | 9,514 | 57,709 |
| **Entrance Fees Subject to Refund** | 626 | 3,690 | 4,316 |
| **Entrance Fees Non-refundable** | 6,044 | 9,667 | 15,711 |
| **Other Liabilities** | 102 | 102 | 204 |
| Total liabilities | 117,116 | 53,435 | 170,551 |
| **Net Deficit Without Donor Restriction** | (52,437) | (8,379) | (60,816) |
| Total liabilities and net deficits | $ 64,679 | $ 45,056 | $ 109,735 |

**HumanGood National Obligated Group**
**(HumanGood Arizona, dba Terraces of Phoenix,**
**and HumanGood Washington, dba Judson Park)**
**(Members of HumanGood Cornerstone)**

Combining Statement of Operations and Changes in Net Deficit Schedule
(In Thousands)
December 31, 2018

| | Terraces of Phoenix | Judson Park | Total Combined |
|---|---|---|---|
| **Operating Revenues** | | | |
| Residential living | $ 9,666 | $ 6,840 | $ 16,506 |
| Assisted living | 3,131 | 2,762 | 5,893 |
| Health center | 6,953 | 9,761 | 16,714 |
| Memory support | 1,746 | 1,434 | 3,180 |
| Other residential services | 102 | 581 | 683 |
| Amortization of entrance fees | 1,198 | 2,639 | 3,837 |
| Other operating revenue | 519 | 439 | 958 |
| Total operating revenues | 23,315 | 24,456 | 47,771 |
| **Operating Expenses** | | | |
| Salaries and wages | 8,885 | 10,364 | 19,249 |
| Employee benefits | 1,872 | 2,298 | 4,170 |
| Supplies | 2,300 | 1,573 | 3,873 |
| Chargeable ancillary services | 1,269 | 1,689 | 2,958 |
| Repairs and maintenance | 196 | 274 | 470 |
| Marketing and advertising | 446 | 262 | 708 |
| Purchased services | 925 | 887 | 1,812 |
| Management fees | 1,631 | 1,851 | 3,482 |
| Utilities | 1,163 | 707 | 1,870 |
| Travel and related | 129 | 83 | 212 |
| Leases and rents | 189 | 95 | 284 |
| Insurance | 303 | 295 | 598 |
| Other operating expenses | 218 | 124 | 342 |
| Total operating expenses | 19,526 | 20,502 | 40,028 |
| **Income Before Other Operating Income (Expense)** | 3,789 | 3,954 | 7,743 |
| **Other Operating Income (Expense)** | | | |
| Investment income, net | 243 | 170 | 413 |
| Mortgage interest | (1,745) | (1,193) | (2,938) |
| Depreciation and amortization | (2,585) | (2,299) | (4,884) |
| Loss on early retirement of debt | (448) | (75) | (523) |
| (Loss) income from operations | (746) | 557 | (189) |
| Change in fair value of interest rate swap and cap | 99 | 240 | 339 |
| Unrealized losses on investments, net | (178) | (45) | (223) |
| Change in net deficit | (825) | 752 | (73) |
| **Beginning Net Deficit As Previously Reported** | (51,544) | - | (51,544) |
| **Adjustments for Adoption of Accounting Pronouncement** | (68) | (206) | (274) |
| **Adjustments for Admission of HumanGood Washington to the National Obligated Group** | - | (8,925) | (8,925) |
| **Beginning Net Deficit As Adjusted for Change in Reporting Entity** | (51,612) | (9,131) | (60,743) |
| **Net Deficit, End of Year** | $ (52,437) | $ (8,379) | $ (60,816) |

**HumanGood National Obligated Group**
**(HumanGood Arizona, dba Terraces of Phoenix,**
**and HumanGood Washington, dba Judson Park)**
**(Members of HumanGood Cornerstone)**

Combining Statement of Cash Flows Schedule
(In Thousands)
December 31, 2018

| | Terraces of Phoenix | Judson Park | Total Combined |
|---|---|---|---|
| **Cash Flows from Operating Activities** | | | |
| Cash received from resident services | $ 21,076 | $ 20,809 | $ 41,885 |
| Cash received from non-rebatable entrance fees from reoccupancy | 1,202 | 1,955 | 3,157 |
| Cash provided by other operating activities | 873 | 779 | 1,652 |
| Cash earnings realized from investments | 246 | 164 | 410 |
| Cash paid for employee salaries | (8,135) | (9,495) | (17,630) |
| Cash paid for employee benefits | (1,853) | (2,294) | (4,147) |
| Cash paid for temporary labor | (876) | (977) | (1,853) |
| Cash paid to vendors | (9,403) | (7,957) | (17,360) |
| Cash paid for interest | (1,792) | (842) | (2,634) |
| Net cash provided by operating activities | 1,338 | 2,142 | 3,480 |
| **Cash Flows from Investing Activities** | | | |
| Acquisition of land, buildings, and equipment, | (1,014) | (1,040) | (2,054) |
| Purchase of unrestricted investments | (668) | (2,179) | (2,847) |
| Proceeds from sale of unrestricted investments | 407 | 2,025 | 2,432 |
| Purchase of restricted investments | (1,597) | (1,389) | (2,986) |
| Net cash used in investing activities | (2,872) | (2,583) | (5,455) |
| **Cash Flows from Financing Activities** | | | |
| Proceeds from rebatable entrance fees | 4,871 | 227 | 5,098 |
| Refunds of deposits and refundable entrance fees | (5,309) | (497) | (5,806) |
| Cash paid for deferred debt issuance costs | (973) | (816) | (1,789) |
| Cash received (paid) from affiliates | 976 | (6,511) | (5,535) |
| Principal payments on notes and bonds payable | (634) | (214) | (848) |
| Proceeds from issuance of notes and bonds payable | 1,235 | 9,940 | 11,175 |
| Net cash provided by financing activities | 166 | 2,129 | 2,295 |
| (Decrease) Increase in cash and cash equivalents | (1,368) | 1,688 | 320 |
| **Cash and Cash Equivalents, Beginning of Year** | 6,638 | 3,998 | 10,636 |
| **Cash and Cash Equivalents, End of Year** | $ 5,270 | $ 5,686 | $ 10,956 |
| **Cash Flows from Operating Activities** | | | |
| Change in net deficit | $ (825) | $ 752 | $ (73) |
| Adjustments to reconcile change in net deficit to net cash provided by operating activities: | | | |
| Amortization of entrance fees | (1,198) | (2,639) | (3,837) |
| Proceeds from non-rebatable entrance fees from reoccupancy | 1,202 | 1,955 | 3,157 |
| Depreciation and amortization | 2,585 | 2,299 | 4,884 |
| Unrealized losses on investments | 178 | 45 | 223 |
| Loss on early retirement of debt | 448 | 75 | 523 |
| Change in fair value of interest rate swap and cap | (99) | (240) | (339) |
| Change in residents accounts receivable and other receivable | 45 | (244) | (199) |
| Change in prepaids, deposits and other assets | 115 | 67 | 182 |
| Other changes in operating assets and liabilities, net | (1,113) | 72 | (1,041) |
| Net cash provided by operating activities | $ 1,338 | $ 2,142 | $ 3,480 |
| **Noncash Disclosures** | | | |
| Long-term debt repaid with proceeds from Series 2018 Bonds | 46,011 | 16,505 | 62,516 |