CC-PALO ALTO, INC. AND SUBSIDIARY

Consolidated Financial Statements and Supplemental Schedules

December 31, 2019 and 2018

(With Independent Auditors' Report Thereon)

CC-PALO ALTO, INC. AND SUBSIDIARY

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KPMG LLP
Aon Center
Suite 5500
200 E. Randolph Street
Chicago, IL 60601-6436

Independent Auditors' Report

The Board of Directors
CC-Palo Alto, Inc. and Subsidiary:

We have audited the accompanying consolidated financial statements of CC-Palo Alto, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations, changes in stockholders' deficit, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated 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 consolidated 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of CC-Palo Alto, Inc. and Subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 2(l) to the consolidated financial statements, in 2019 CC-Palo Alto, Inc. and Subsidiary adopted new accounting guidance for Accounting Standards Update (ASU) No. 2014-09, *Revenue from*

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Contracts with Customers (Topic 606) and ASU No. 2016-18, *Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*. Our opinion is not modified with respect to these matters.

Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Form 5-1 through Form 5-5 is presented for purposes of additional analysis and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with 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 consolidated financial statements as a whole.

KPMG LLP

Chicago, Illinois
April 20, 2020

CC-PALO ALTO, INC. AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2019 and 2018

Assets		2019	2018
Current assets:			
Cash and cash equivalents	$	27,810,858	6,234,052
Short-term investments		4,144,470	21,905,582
Current portion of assets limited as to use		513,410	1,010,270
Resident accounts receivable		972,045	692,380
Prepaids and other		814,079	1,429,892
Total current assets		34,254,862	31,272,176
Long-term investments		59,507,732	34,884,070
Assets limited as to use, net of amounts required for current liabilities		21,292,586	26,200,752
Property and equipment:			
Land improvements		15,710,971	15,547,667
Building and improvements		206,468,345	205,947,412
Furniture, fixtures, and equipment		18,235,046	38,033,126
Construction in progress		8,966,535	2,882,673
		249,380,897	262,410,878
Less accumulated depreciation		100,006,903	115,347,311
Property and equipment, net		149,373,994	147,063,567
Deferred tax asset, net		12,932,474	11,234,747
Deposits		1,277,290	1,250,513
Total assets	$	278,638,938	251,905,825
Liabilities and Stockholders' Deficit			
Current liabilities:			
Accounts payable	$	1,775,112	1,801,152
Accrued expenses		6,870,993	6,947,705
Due to affiliates		3,936,359	2,060,908
Prepaid resident service revenue		906,980	517,809
Resident deposits		513,410	1,010,270
Current portion of repayable entrance fees		4,852,760	8,067,876
Total current liabilities		18,855,614	20,405,720
Repayable entrance fees		476,489,627	464,462,625
Deferred revenue from nonrepayable entrance fees		99,880,209	82,762,932
Other liabilities		234,788	213,955
Total liabilities		595,460,238	567,845,232
Stockholders' deficit:			
Common stock, no par value, no assigned value. Authorized, issued, and outstanding, 100 shares		—	—
Distributions in excess of paid-in capital		(185,648,736)	(185,648,736)
Accumulated deficit		(131,172,564)	(130,290,671)
Total stockholders' deficit		(316,821,300)	(315,939,407)
Total liabilities and stockholders' deficit	$	278,638,938	251,905,825

See accompanying notes to consolidated financial statements.

CC-PALO ALTO, INC. AND SUBSIDIARY

Consolidated Statements of Operations

Years ended December 31, 2019 and 2018

		2019	2018
Revenue:			
Net resident service revenue	$	47,453,513	45,997,622
Amortization of entrance fees		9,913,277	8,995,507
Investment return		2,626,476	805,782
Other income		338,110	274,478
Total revenue		60,331,376	56,073,389
Expenses:			
Culinary and dining		7,076,962	6,464,434
Housekeeping and laundry		2,900,047	2,701,892
Resident services		4,058,860	3,956,734
Resident care		9,213,520	8,818,866
Repairs and maintenance		2,582,255	2,129,960
Sales and marketing		950,781	882,689
Administration		4,978,223	7,585,997
Utilities		2,139,060	1,991,087
Insurance		1,737,126	1,314,169
Total departmental expenses		35,636,834	35,845,828
Management fees		3,855,609	3,714,295
Property taxes, net		5,089,446	(854,158)
Ground lease base rent		1,717,350	1,717,350
Ground lease participating rent		7,573,819	6,070,564
Loss on disposal of property and equipment		7,322	—
Other expense		97,548	407,330
Depreciation and amortization		7,370,545	7,160,873
Total expenses		61,348,473	54,062,082
Income (loss) before income taxes		(1,017,097)	2,011,307
Income tax benefit (expense)		279,828	(560,590)
Net income (loss)	$	(737,269)	1,450,717

See accompanying notes to consolidated financial statements.

CC-PALO ALTO, INC. AND SUBSIDIARY

Consolidated Statements of Changes in Stockholders' Deficit

Years ended December 31, 2019 and 2018

	Common stock		Distributions in excess of paid-in capital	Accumulated deficit	Total
	Shares	Amount			
Balance at December 31, 2017	100	$ —	(185,648,736)	(131,596,724)	(317,245,460)
Tax adjustment	—	—	—	(144,664)	(144,664)
Net income	—	—	—	1,450,717	1,450,717
Balance at December 31, 2018	100	—	(185,648,736)	(130,290,671)	(315,939,407)
Tax adjustment	—	—	—	(144,624)	(144,624)
Net loss	—	—	—	(737,269)	(737,269)
Balance at December 31, 2019	100	$ —	(185,648,736)	(131,172,564)	(316,821,300)

See accompanying notes to consolidated financial statements.

CC-PALO ALTO, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

Years ended December 31, 2019 and 2018

		2019	2018
Cash flows from operating activities:			
Cash received from residents with continuing care contracts	$	37,907,692	35,845,483
Cash received from residents without continuing care contracts		9,833,703	9,376,952
Proceeds received from nonrepayable entrance fees		27,284,120	16,227,960
Interest received		2,054,140	1,045,154
Cash paid to suppliers and employees		(35,069,164)	(35,861,325)
Cash paid for management fees		(3,855,609)	(3,714,295)
Cash paid for real estate taxes		(5,089,446)	(4,575,004)
Cash paid for participating rent		(7,573,819)	(6,070,564)
Cash paid for income taxes		(1,562,523)	(617,895)
Net cash provided by operating activities		23,929,094	11,656,466
Cash flows from investing activities:			
Additions to property and equipment		(9,688,294)	(6,417,168)
Purchase of investments, net		(6,464,690)	(56,789,652)
Net change in resident deposits		(496,860)	521,890
Net change in assets limited as to use		11,405,566	(1,997,811)
Net cash used in investing activities		(5,244,278)	(64,682,741)
Cash flows from financing activities:			
Proceeds from repayable entrance fees		39,358,980	31,582,050
Entrance fee repayments		(30,640,926)	(24,091,969)
Net cash provided by financing activities		8,718,054	7,490,081
Net change in cash, cash equivalents, and restricted cash		27,402,870	(45,536,194)
Cash, cash equivalents, and restricted cash at beginning of year		10,833,545	56,369,739
Cash, cash equivalents, and restricted cash at end of year	$	38,236,415	10,833,545
Reconciliation of net income (loss) to net cash provided by operating activities:			
Net income (loss)	$	(737,269)	1,450,717
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Proceeds from nonrepayable entrance fees		27,284,120	16,227,960
Depreciation and amortization		7,370,545	7,160,873
Amortization of entrance fees		(9,913,277)	(8,995,507)
Net realized and change in unrealized (gains) losses		(572,336)	239,372
Utilization of repayable entrance fees in lieu of monthly fees		(159,734)	(76,335)
Loss on disposal of property and equipment		7,322	—
Income tax adjustment		(144,624)	(144,664)
Changes in assets and liabilities:			
Accounts receivable		(279,665)	32,413
Prepaids and other		615,813	(1,087,577)
Deposits		(26,777)	(21,744)
Accounts payable		(26,040)	601,489
Accrued expenses		(76,712)	(5,128,372)
Due to affiliates		1,875,451	2,329,871
Prepaid resident service revenue		389,171	(1,005,743)
Deferred tax asset		(1,697,727)	87,359
Other liabilities		20,833	(13,646)
Net cash provided by operating activities	$	23,929,094	11,656,466

See accompanying notes to consolidated financial statements.

(1) Purpose and Organization

The accompanying consolidated financial statements include the accounts of CC-Palo Alto, Inc. (the Company) and its consolidated affiliate, Palo Alto Care Center, Inc. The Company and Palo Alto Care Center, Inc. are both subsidiaries of CC-Development Group, Inc. (Parent).

The Company, a Delaware corporation, was incorporated on June 23, 1999 for the purpose of developing, owning, and operating a 494-unit senior living community (the Community) in Palo Alto, California. The Community comprises 388 units of independent living and a 106-unit care center that includes units of assisted living, memory support, and skilled nursing. The independent living component of the community opened in 2005, followed by the assisted living, memory support, and skilled nursing units of the care center in 2006.

Palo Alto Care Center, Inc. was incorporated for the purpose of owning the care center and leasing it back to the Company. The Company applies Accounting Standards Codification (ASC) Subtopic 810-10, *Consolidation – Overall*, to its variable interest in Palo Alto Care Center, Inc., whereby the entity is consolidated with the Company due to the Company's controlling financial interest in Palo Alto Care Center, Inc.

All significant intercompany balances and transactions have been eliminated in consolidation.

(2) Summary of Significant Accounting Principles

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Cash, Cash Equivalents, and Restricted Cash

Cash, cash equivalents, and restricted cash include investments in highly liquid instruments with original maturities of three months or less. The following table provides a reconciliation of cash, cash equivalents, and restricted cash as reported in the accompanying consolidated balance sheets to the total amount of cash, cash equivalents, and restricted cash as reported in the accompanying consolidated statements of cash flows:

		2019	2018
Cash and cash equivalents	$	27,810,858	6,234,052
Assets limited as to use:			
Cash and cash equivalents		4,788,878	1,330,858
Money markets and certificates of deposit		5,636,679	3,268,635
Total cash, cash equivalents, and restricted cash reported in the consolidated statements of cash flows	$	38,236,415	10,833,545

(c) Fair Value Measurements

The Company applies the provisions of Accounting Standards Codification (ASC) Subtopic 820-10, *Fair Value Measurement – Overall*, to provide additional disclosure requirements for transfers into and out of Levels 1 and 2 and for activity in Level 3 and to clarify other existing disclosure requirements.

ASC Subtopic 820-10 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. ASC Subtopic 820-10 also establishes a framework for measuring fair value and expands disclosures about fair value measurements.

ASC Subtopic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 inputs are 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.

Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

(d) Investments

Short-term investments include investments in highly liquid instruments with original maturities greater than 3 months and less than 12 months, excluding assets limited as to use. Long-term investments include corporate bonds and notes with original maturities greater than 12 months.

(e) Assets Limited as to Use

Assets limited as to use include restricted resident deposits, assets held for entrance fee repayments, assets held by the Company under Ground Lease Agreement (note 5), and assets set aside by the Company for the Community's operations and capital improvements, in accordance with the Company's policies. Restricted resident deposits represent good faith deposits received by the Company upon the commitment of prospective residents to enter into a residency agreement. Assets held for entrance fee repayments represent funds designated to establish certain entrance fee repayments reserves. Assets held for entrance fee repayments are comprised entirely of cash and cash equivalents. Assets held by the Company under Ground Lease Agreement represent funds designated to secure payments under the ground lease (note 5). Assets held for operations are for funding operating reserves over which the Company retains control and may use in accordance with

the Company's policies. Assets limited as to use for capital improvements represent funds designated by the Company for acquisition of property and equipment, in accordance with the Company's policies.

(f) Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets ranging from 4 to 40 years. Construction in progress at December 31, 2019 includes approximately $8,937,000 of costs associated with independent living common area renovations that will be placed in service during 2020. No significant contractual commitments exist related to these renovations as of December 31, 2019.

(g) Impairment of Long-Lived Assets

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. If the Company intended to dispose of its assets, they would be reported at the lower of the carrying amount or fair value less estimable costs to sell, and would no longer be depreciated. The Company does not believe that there are any factors or circumstances indicating impairment of its long-lived assets as of December 31, 2019 or 2018.

(h) Obligation to Provide Future Services

The Company annually calculates the present value of the estimated net cost of future services and the use of facilities to be provided to current residents and compares that amount with the balance of unearned revenue from entrance fees. If the present value of the net costs of future services and the use of facilities exceeds the unearned revenue from entrance fees, a liability is recorded (obligation to provide future services) with the corresponding charge to income. The obligation is discounted at an actuarially determined rate of 5.5%. The present value of the net cost of future services and the use of facilities was less than the deferred revenue from entrance fees at December 31, 2019 and 2018, and accordingly, no obligation to provide future services has been recognized in the accompanying consolidated balance sheets.

(i) Repayable Entrance Fees

Residents enter into a residency agreement with the Company that requires the payment of a one time entrance fee. Upon termination of the residency agreement, residents are entitled to a repayment of the portion of the entrance fee that has not been earned by the Company. For contracts entered into through December 31, 2016, this repayment becomes payable upon the sooner of reoccupancy of the unit or 10 years after the unit is made available. Subsequent to January 1, 2017, the repayment is payable upon reoccupancy. The Company earns an administrative fee upon admission and 2% of the entrance fee per month up to a maximum of 100%, 40%, 30%, 25%, 20%, or 10% dependent on the contract provisions of the residency agreement. The Company amortizes the nonrepayable portion of the entrance fee over the estimated life of the residents. The Company has recorded the repayable portion of the entrance fees separately from the nonrepayable portion within the accompanying

consolidated balance sheets. If all contracts terminated on December 31, 2019, the repayable portion of the entrance fees due to all residents would be approximately $496,968,000.

(j) Ground Lease Participating Rent

Pursuant to its Ground Lease Agreement with The Board of Trustees of the Leland Stanford Junior University (note 5), beginning with initial occupancy of the Community, the Company pays a percentage of all gross receipts to Stanford University, as defined in the Ground Lease Agreement. Gross receipts include net resident service revenue, other income, and proceeds from entrance fees net of certain repayments. The payments are recognized as expense in their entirety in the period in which the related net resident service revenue and other income are recognized, and in the period in which the proceeds from entrance fees are received.

(k) Income Taxes

The Company is included in the consolidated income tax return of its Parent. The Company uses the separate return method of determining its provision for income taxes. The consolidated financial statements reflect the provision for income taxes as if the Company were a separate taxpayer and a stand-alone enterprise. Accordingly, the consolidated financial statements may reflect tax attributes that may not exist in the Parent's consolidated income tax return. A valuation allowance on deferred tax assets is assessed using the sources of future taxable income available only to the Company.

Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred income taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company accounts for tax provisions in accordance with ASC Topic 740, *Income Taxes*. ASC Topic 740 clarifies the accounting for uncertainty in tax positions and also provides guidance on when the tax positions are recognized in an entity's financial statements and how the values of these positions are determined. The Company has recognized no liabilities as of December 31, 2019 and 2018 related to uncertain tax positions.

(l) New Accounting Pronouncements

In May 2014, Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (ASC 606)*. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. ASU No. 2014-09 requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The requirements of this statement are effective for the Company for the year ended December 31, 2019. The Company adopted this guidance as of January 1, 2019 under the modified retrospective approach. The adoption did not have a material impact on the Company's consolidated balance sheets, results of operations, or cash flows, other than expanded disclosures. There was no cumulative effect of a change in accounting principle recorded related to the adoption.

In November 2016, FASB issued ASU No. 2016-18, *Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*. ASU No. 2016-18 requires an entity to include amounts generally described as restricted cash and restricted cash equivalents, along with cash and cash equivalents when reconciling beginning and ending balances on the consolidated statements of cash flows. ASU No. 2016-18 is effective for nonpublic business entities for annual reporting periods beginning after December 15, 2018, with retrospective application and disclosure. The Company adopted this guidance in 2019 and retrospectively applied it to the 2018 consolidated statements of cash flows. Within the consolidated statements of cash flows, net change in assets limited as to use for the year ended December 31, 2018 was adjusted by $3,160,305 and cash, cash equivalents, and restricted cash at December 31, 2017 was adjusted by $7,759,798.

In February 2016, FASB issued ASU 2016-02, *Leases*. ASU 2016-02 requires entities to recognize all leased assets as assets on the balance sheet with a corresponding liability resulting in a gross up of the balance sheet. Entities will also be required to present additional disclosures regarding the nature and extent of leasing activities. The requirements of this statement are effective for the Company for the year ending December 31, 2021. The Company is evaluating the impact of this standard on the accompanying consolidated balance sheet and statement of operations.

(m) Reclassifications

Certain 2018 amounts have been reclassified to conform to the 2019 consolidated financial statement presentation. Reclassifications also include the adoption of new accounting standards as discussed in note 2(l) above.

(n) Subsequent Events

In connection with the preparation of the consolidated financial statements and in accordance with ASC Topic 855, *Subsequent Events*, the Company evaluated events and transactions through April 20, 2020, the date the consolidated financial statements were available to be issued, noting no subsequent events requiring recording or disclosure in the consolidated financial statements or related notes to the consolidated financial statements.

(3) Net Resident Service Revenue

Net resident service revenue is reported at amounts that reflect the consideration which the Company expects to receive in exchange for services provided. These amounts are due from residents or third-party payors and include variable consideration for retroactive revenue adjustments, if any, under reimbursement programs. Performance obligations are determined based on the nature of the services provided. During 2019, the Company determined that it would return a portion of its excess cash flows generated from operations back to its residents as a reduction of 2019 monthly fees in the amount of $562,532.

(a) Daily or Monthly Fee Revenue

Under the Company's residency agreements, which are continuing care contracts, the Company provides senior living services to residents for a stated monthly fee. The Company recognizes revenue for skilled nursing residency, assistance with activities of daily living, memory care services, inpatient therapy, healthcare, and personalized health services in accordance with the provisions of ASC 606. The Company has determined that the services included under the daily or 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.

(b) Healthcare Services Revenue

The Company receives revenue for services under various third-party payor programs, which include Medicare, and other third-party payors. Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are included in the determination of the estimated transaction price for providing services. The Company estimates the transaction price based on the terms of the contract with the payor, correspondence with the payor, and historical payment trends, and retroactive adjustments are recognized in future periods as final settlements are determined.

(c) Disaggregation of Revenue

The Company disaggregates its revenue from contracts with customers by revenue type, as the Company believes it best depicts how the nature, amount, timing, and uncertainty of its revenue and cash flows are affected by economic factors. See details on revenue type below:

		2019	2018
Independent living revenue	$	32,845,421	32,080,284
Care center revenue:			
Revenue under continuing care residency agreements		4,018,185	3,732,590
Revenue from private payors		3,214,953	2,829,424
Revenue under Medicare and third-party arrangements		6,438,957	6,457,432
Other service revenue		935,997	897,892
Net resident service revenue	$	47,453,513	45,997,622
Amortization of entrance fee revenue	$	9,913,277	8,995,507
Other income		338,110	274,478

(d) Contract Balances

The payment terms and conditions within the Company's revenue-generating contracts vary by contract type and payor source, although terms generally include payment to be made within 30 days. Resident fee revenue for recurring and routine monthly services is generally billed monthly in advance.

Resident fee revenue for standalone or certain healthcare services is generally billed monthly in arrears. Amounts of revenue that are collected from residents in advance are recognized as deferred revenue until the performance obligations are satisfied. The Company had total deferred revenue (included within prepaid resident service revenue and deferred revenue from nonrepayable entrance fees within the balance sheets) of $100,787,189 and $83,280,741, including $906,980 and $517,809 of resident monthly fees billed and received in advance, as of December 31, 2019 and 2018, respectively. For the year ended December 31, 2019, the Company recognized $9,550,660 of revenue that was included in the deferred revenue balance as of January 1, 2019. The Company applies the practical expedient in ASC 606-10-50-14 and does not disclose amounts for remaining performance obligations that have original expected durations of one year or less.

(4) Concentration of Credit Risk

The Company grants credit to its self-pay residents as well as those that are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of December 31, 2019 and 2018 is as follows:

	2019	2018
Medicare	61 %	65 %
Self-pay and commercial insurance	39	35
	100 %	100 %

(5) Investments

The Company reports its investments and assets limited as to use as trading securities. Money market funds with readily determinable fair values and all other investments are reported at fair value. Fair value is determined primarily on the basis of quoted market prices or observable market inputs. Cash and cash equivalents, money market funds with readily determinable fair values, certificates of deposit, and U.S. Treasury securities are considered Level 1 investments within the fair value hierarchy. Corporate bonds and notes are considered Level 2 investments within the fair value hierarchy. Investment income or loss (including realized gains and losses on investments, changes in unrealized gains and losses on trading securities, interest, and dividends) is reported as investment return in the accompanying consolidated statements of operations.

A summary of the composition of the Company's investment portfolio at December 31, 2019 and 2018 is as follows:

	2019	2018
Cash and cash equivalents	$ 4,788,878	1,330,858
Money markets and certificates of deposit	14,659,033	19,673,121
U.S. Treasury securities	5,380,439	10,130,670
Corporate bonds and notes	60,629,848	52,866,025
	$ 85,458,198	84,000,674

Investments are reported in the accompanying consolidated balance sheets as follows:

		2019	2018
Short-term investments	$	4,144,470	21,905,582
Current portion of assets limited as to use – resident deposits		513,410	1,010,270
Assets limited as to use – by Company for capital improvements		6,861,735	11,599,867
Assets limited as to use – by Company for operations		2,386,530	2,597,811
Assets limited as to use – by Company for entrance fee repayments		6,044,321	6,003,074
Assets limited as to use – by Company for ground lease		6,000,000	6,000,000
Assets limited as to use, net of amounts required for current liabilities		21,292,586	26,200,752
Long-term investments		59,507,732	34,884,070
	$	85,458,198	84,000,674

The following table presents the Company's fair value hierarchy for those investments and assets limited as to use measured at fair value on a recurring basis as of December 31, 2019. None of these assets has any redemption restrictions so the redemption frequency is on a daily basis and would have a one-day notice for redemption.

		Fair value	Level 1	Level 2	Level 3
Cash and cash equivalents	$	4,788,878	4,788,878	—	—
Money markets and certificates of deposit		14,659,033	14,659,033	—	—
U.S. Treasury securities		5,380,439	5,380,439	—	—
Corporate bonds and notes		60,629,848	—	60,629,848	—
Total	$	85,458,198	24,828,350	60,629,848	—

The following table presents the Company's fair value hierarchy for those investments and assets limited as to use measured at fair value on a recurring basis as of December 31, 2018. None of these assets has

any redemption restrictions so the redemption frequency is on a daily basis and would have a one-day notice for redemption.

		Fair value	Level 1	Level 2	Level 3
Cash and cash equivalents	$	1,330,858	1,330,858	—	—
Money markets and certificates of deposit		19,673,121	19,673,121	—	—
U.S. Treasury securities		10,130,670	10,130,670	—	—
Corporate bonds and notes		52,866,025	—	52,866,025	—
Total	$	84,000,674	31,134,649	52,866,025	—

The composition of investment return on the Company's investment portfolio for the years ended December 31, 2019 and 2018 is as follows:

		2019	2018
Interest and dividend income	$	2,054,140	1,045,154
Net realized and change in unrealized gains and losses during the holding period		572,336	(239,372)
	$	2,626,476	805,782

(6) Ground Lease

On August 1, 2000, the Company entered into a 75-year Ground Lease Agreement with The Board of Trustees of the Leland Stanford Junior University (Lessor). During the construction period, the lease called for monthly payments of $125,000 plus annual Consumer Price Index (CPI) increases. The lease payments began with the commencement of the construction of the Community in July 2003. After initial occupancy, the monthly payments reset to $125,000 and are adjusted every five years to reflect increases in CPI; the maximum CPI increase is 7% for a five year period. The monthly payments for the years ended December 31, 2019 and 2018 totaled $1,717,350. The ground lease also requires participating rent of approximately 6% of all gross receipts, payable monthly beginning with the initial occupancy, as defined.

In February 2002, the Company paid a $1,000,000 deposit as required by the Ground Lease Agreement. The Ground Lease Agreement also requires that the Company maintain a letter of credit in the amount of $6,000,000 as security for the Company's performance of its obligations under the lease.

(7) Transactions with Related Parties

The Company entered into a management agreement dated August 1, 2000 between the Company and Classic Residence Management Limited Partnership (Classic), an affiliate of the Company, whereby Classic manages the operations of the Company. The agreement is for a term of 55 years and requires the Company to pay an annual management fee equal to 8% of annual resident service revenue, excluding certain items as defined in the management agreement. The Company incurred management fee expense of $3,855,609 and $3,714,295 for the years ended December 31, 2019 and 2018, respectively.

Classic also contracts with third parties on behalf of the Company to provide property, health, and liability insurance and various marketing and other services. Classic advances the funds to the third parties on behalf of the Company. Such advances amounted to $5,505,017 and $5,652,781 for the years ended December 31, 2019 and 2018, respectively. There is no interest associated with these advances as they are reimbursed on a current basis. Amounts to Classic of $3,936,959 and $2,060,908 at December 31, 2019 and 2018, respectively, are reflected as due to affiliates in the accompanying consolidated balance sheets.

(8) Defined Contribution Plan

The employees of the Company participate in a savings plan (the Plan) administered by Classic. The Plan is qualified under Section 401(k) of the Internal Revenue Code for all full-time employees who are 21 years of age with six months of service. The Plan allows eligible employees to defer up to 25% of their income on a pretax basis through contributions to the Plan. In accordance with the provisions of the Plan, for every dollar up to 4% of a participant's salary, the Company matches each participant's contribution in an amount equal to 100% of the participant's deferral. For every dollar in excess of 4% of a participant's salary and limited to 6% of a participant's salary, the Company matches each participant's contribution in an amount equal to 50% of the participant's deferral. For the years ended December 31, 2019 and 2018, the Company recorded matching contribution expense of $460,550 and $443,900, respectively. Contributions are funded on a current basis.

(9) Income Taxes

The operating results of the Company are included in the Parent's consolidated federal income tax return. The Company is party to a tax sharing agreement, which follows the provisions of ASC Topic 740 and provides that, among other things, the Company shall not be entitled to any reimbursement for utilization of its tax attributes in the consolidated federal income tax return of the Parent. The tax sharing agreement also provides that the Company shall not be entitled to any reimbursement for utilization of its tax attributes in the various combined state income tax returns of the Parent and its subsidiaries. The Company is required to pay the Parent for any tax liability that may arise from its operations, computed on a separate return basis. For the years ended December 31, 2019 and 2018, Palo Alto Care Center, Inc. sustained losses for federal and state income tax purposes. Accordingly, the current tax benefit attributable to Palo Alto Care Center, Inc. in the Parent's income tax return has been eliminated through an adjustment to stockholders' deficit.

The income tax expense (benefit) for the years ended December 31, 2019 and 2018 comprises the following:

		2019	2018
Current:			
U.S. federal	$	962,388	308,978
State		455,511	164,253
Total current		1,417,899	473,231
Deferred:			
U.S. federal		(1,274,042)	65,558
State		(423,685)	21,801
Total deferred		(1,697,727)	87,359
Income tax (benefit) expense	$	(279,828)	560,590

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are presented below:

		2019	2018
Deferred tax assets:			
Deferred revenue from nonrepayable entrance fees	$	22,219,534	19,256,656
Property tax liabilities		913,283	875,694
Other		747,248	723,772
Gross deferred tax assets		23,880,065	20,856,122
Less valuation allowance		—	—
Net deferred tax assets		23,880,065	20,856,122
Deferred tax liabilities:			
Depreciation		(10,875,042)	(9,617,242)
Other		(72,549)	(4,133)
Gross deferred tax liabilities		(10,947,591)	(9,621,375)
Total deferred tax asset, net	$	12,932,474	11,234,747

As of December 31, 2019 and 2018, no valuation allowance was considered necessary as management believed that it was more likely than not that the results of future operations would generate sufficient taxable income to realize the deferred tax assets.

Income tax expense (benefit) was $(279,828) and $560,590 for the years ended December 31, 2019 and 2018, respectively, and differed from the amounts computed by applying the U.S. federal income tax rate of 21% in 2019 and 2018 to pretax income from continuing operations as a result of the following:

		2019	2018
Computed "expected" tax expense (benefit)	$	(213,590)	422,374
Change in income tax expense resulting from:			
State and local income taxes, net of federal income tax expense		(63,832)	151,561
Other, net		(2,406)	(13,345)
	$	(279,828)	560,590

(10) Commitments and Contingencies

(a) State Regulatory Requirements

The Company is subject to regulatory requirements as set forth by the Department of Social Services in the State of California. Such requirements set forth the establishment of a restricted cash escrow account for resident deposits until execution of the residency agreement (note 2) and the submission of schedules detailing the availability of debt service and operating expense reserves.

(b) Legal and Regulatory

The laws and regulations governing the Medicare programs are extremely complex and subject to interpretation, making compliance an ongoing challenge for long-term care organizations. Recently, the federal government has increased its enforcement activity, including audits and investigations related to billing practices, clinical documentation, and related matters. The Company maintains a compliance program designed to educate employees and to detect and correct possible violations.

(c) Regulatory Investigations

The U.S. Department of Justice (DOJ) and other federal agencies routinely conduct regulatory investigations and compliance audits of healthcare providers. The Company is subject to these regulatory efforts. On May 22, 2017, Classic Residence Management Limited Partnership (Classic) was notified by the DOJ that it was initiating an investigation of CC-Development Group, Inc. (Parent) pursuant to the federal Fair Housing Act. While the notification did not specifically name the Company, Classic has produced requested documents related to certain subsidiaries of the Parent. Interviews with personnel were conducted in May 2019 and resolution is expected to take place in 2020. Management is currently unaware of any regulatory matters that may have a material adverse effect on the Company and its consolidated financial position, statements of operations, or cash flows.

(d) Business Disruption

Subsequent to year end, a public health emergency of international concern was declared due to the COVID-19 virus. As a result of the outbreak, there has been instability in the capital markets and disruption in the senior living industry. The ultimate impact of the COVID-19 outbreak is highly uncertain. The Company's business and investment values are likely to be impacted as a result of the outbreak. Management does not yet know the full extent of potential impacts on the business but is actively monitoring.

(e) Real Estate Tax Assessment

The Company has been contesting the real estate taxes on the Community's building improvements and the underlying leased land for each year from November 2005 and forward. The principal issue in dispute has been the proper assessed value of the building improvements which were completed in November 2005. Hearings before the Santa Clara County Assessment Appeals Board (the Board) were completed in 2016 and briefing completed in 2017. The Board issued its decision on June 20, 2018 setting $266,000,000 as the assessed value of the building improvements as of the November 2005 completion date. The Board's $266,000,000 building improvement value, along with its valuation of the underlying land at $74,653,800, set a total $340,653,800 base year value for the real property as of November 2005. Absent new construction or a change in ownership of the real property, Proposition 13 limits future increases in assessed value to 2% or less per year.

The Board's newly determined $266,000,000 November 2005 base year value for the improvements reflects an increase of roughly $19,000,000 over the Santa Clara County Assessor's (the Assessor) initial November 2005 base year value of $247,000,000 for the improvements. The Assessor challenged his own determination of the assessed value during both Board hearings (the first in 2011 and the second in 2015-2016). The first hearing resulted in a 2012 Board decision that increased the Assessor's initial assessed value by $155,000,000. After the Company appealed that decision, the Santa Clara County Superior Court vacated it and directed the Board to hold a new hearing. The result of that court-ordered second hearing was the Board's June 20, 2018 issuance of its newly determined $340,653,800 November 2005 base year value. The Board's written findings in support of the June 20, 2018 decision were issued on January 17, 2019.

The Company has received supplemental and escape assessments for the 2005-2006 through 2018-2019 tax years reflecting the Board's newly determined $340,653,800 November 2005 base year value. The increases to the 2005-2006 to 2018-2019 assessed values from these supplemental and escape assessment increases (and the resultant annual Proposition 13 assessment increases of 2% or less) have produced incremental property tax billings through June 30, 2019 of approximately $3,264,000, which the Company has reflected within accrued expenses in the accompanying 2019 consolidated balance sheet. The Company included $3,129,000 in accrued expenses in the 2018 consolidated balance sheet. The Company included $8,558,000 in accrued expenses as of December 31, 2017 based on the status at that time. Accordingly, the Company reduced property tax expense by $5,429,000 in the accompanying 2018 consolidated statements of operations.

(f) Contingency

On February 19, 2014, a class action complaint was filed against the Company, Classic, and the Parent. The Complaint was dismissed on November 25, 2014. On December 10, 2014, the First Amended Complaint (FAC) was filed. In addition to the Corporate defendants, the FAC added former and current members of the Board of Directors of CC-Palo Alto, Inc. as individual defendants. The FAC was dismissed on March 31, 2016. On April 15, 2016, the Second Amended Complaint (SAC) was filed. On September 25, 2017, the court struck the first ten causes of action in the SAC, including all class action claims. On February 14, 2018, the court granted Defendants Motion for Summary Judgement and entered judgement in favor of Defendants on the remaining causes of action in the SAC alleging (1) creditor derivative claims against the director defendants for breach of fiduciary duties, payment of unlawful dividends, and corporate waste; (2) a creditor derivative claim against the Parent for aiding and abetting the director defendants' breaches of fiduciary duties; and (3) a direct claim against the Parent for improper transfer of assets. Plantiffs filed Notice of Appeal on March 11, 2019 and the Company's brief was filed on October 18, 2019. Oral arguments have been scheduled for April, 2020. The Company believes that the matter will be resolved without material adverse effect on the Company's financial position, results of operations, or cash flows

CC-PALO ALTO, INC. AND SUBSIDIARY

Form 5-1

Long-Term Debt Incurred in a Prior Fiscal Year
(Including Balloon Debt)

Long-term debt obligation	(a) Date incurred	(b) Principal paid during fiscal year	(c) Interest paid during fiscal year	(d) Credit enhancement premiums paid in fiscal year	(e) Total paid (columns (b)+ (c) + (d))
1	—	$ —	—	—	—
2	—	—	—	—	—
3	—	—	—	—	—
4	—	—	—	—	—
5	—	—	—	—	—
6	—	—	—	—	—
7	—	—	—	—	—
8	—	—	—	—	—
			$ —	—	—
					(Transfer this amount to Form 5-3, line 1)

Note: For column (b), do not include voluntary payments made to pay down principal.

PROVIDER: CC-Palo Alto, Inc.

COMMUNITY: CC-Palo Alto, Inc.

See accompanying independent auditors' report on supplementary information.

CC-PALO ALTO, INC. AND SUBSIDIARY

Form 5-2

Long-Term Debt Incurred during Fiscal Year
(Including Balloon Debt)

Long-term debt obligation	(a) Date incurred	(b) Total interest paid during fiscal year	(c) Amount of most recent payment on the debt	(d) Number of payments over next 12 months	(e) Reserve requirement (see instruction 5) (columns (c)*(d))
1	—	$ —	—	—	—
2	—	—	—	—	—
3	—	—	—	—	—
4	—	—	—	—	—
5	—	—	—	—	—
6	—	—	—	—	—
7	—	—	—	—	—
8	—	—	—	—	—
			$ —	—	—
					(Transfer this amount to Form 5-3, line 2)

Note: For column (b), do not include voluntary payments made to pay down principal.

PROVIDER: CC-Palo Alto, Inc.

COMMUNITY: CC-Palo Alto, Inc.

See accompanying independent auditors' report on supplementary information.

CC-PALO ALTO, INC. AND SUBSIDIARY

Form 5-3

Calculation of Long-Term Debt Reserve Amount

Line				Total
1	Total from Form 5-1 bottom of Column (e)			$ —
2	Total from Form 5-2 bottom of Column (e)			—
3	Facility leasehold or rental payment paid by provider during fiscal year (including related payments such as lease insurance)			4,584,847
4	Total amount required for long-term debt reserve (A)			$ 4,584,847
(A)	Amount is comprised of the following (see note 5 in the notes to the consolidated financial statements):			
	Ground lease Base Rent		$ 1,717,350	
	Resident service and other revenue	$ 47,791,623		
	Participating Rent percentage	6.0 %		
	2019 Participating Rent on resident service and other revenue (B)		2,867,497	
	Total		$ 4,584,847	

(B) As described in note 5 to the consolidated financial statements, pursuant to its Ground Lease Agreement, the Provider pays the lessor approximately 6.0% of resident service revenue and approximately 7.0% of gross entrance fee proceeds collected. Based on discussions with the State of California Department of Social Services (DSS), and consistent with prior years, facility leasehold or rental payments reportable on Form 5-3 should only include base rent and participating rent attributable to resident service and other revenue.

PROVIDER: CC-Palo Alto, Inc.

COMMUNITY: CC-Palo Alto, Inc.

See accompanying independent auditors' report on supplementary information.

CC-PALO ALTO, INC. AND SUBSIDIARY

Form 5-4

Calculation of Net Operating Expenses

Line		Amounts	Total
1	Total operating expenses from financial statements		$ 61,348,473
2	Deductions:		
	(a) Interest paid on long-term debt (see instructions)	$ —	
	(b) Credit enhancement premiums paid for long-term debt (see instructions)	—	
	(c) Depreciation	7,370,545	
	(d) Amortization	—	
	(e) Revenues received during fiscal year for services to residents who did not have a continuing care contract	9,833,703	
	(f) Extraordinary expenses approved by the Department (A)	4,584,847	
3	Total deductions		21,789,095
4	Net operating expenses		39,559,378
5	Divide Line 4 by 365 and enter the result		108,382
6	**Multiply Line 5 by 75 and enter the result.** This is the provider's operating expense reserve amount		$ 8,128,650
(A)	Extraordinary expenses approved by the department consist of amounts classified as debt service as follows:		
	Ground Lease Base Rent (see Form 5-3)	1,717,350	
	Participating Rent on Resident Service and other Revenue (see Form 5-3)	2,867,497	
		$ 4,584,847	

PROVIDER: CC-Palo Alto, Inc.

COMMUNITY: CC-Palo Alto, Inc.

See accompanying independent auditors' report on supplementary information.

CC-PALO ALTO, INC. AND SUBSIDIARY

Form 5-5

Annual Reserve Certification

Provider Name: CC-Palo Alto, Inc.

Fiscal year ended December 31, 2019
We have reviewed our debt service reserve and operating expense reserve requirements as of and for the fiscal year ended December 31, 2019 and are in compliance with those requirements.

Our liquid reserve requirements computed using the audited financial statements for the fiscal years are as follows:

			Amount
(1)	Debt service reserve amount	$	4,584,847
(2)	Operating expense reserve amount		8,128,650
(3)	Total liquid reserve amount	$	12,713,497

Qualifying assets sufficient to fulfill the above requirements are held as follows:

	Qualifying asset description		Amount (market value at end of quarter) Debt service reserve		Amount (market value at end of quarter) Operating reserve
(4)	Cash and cash equivalents	$	4,584,847		23,226,011
(5)	Investment securities		—		66,038,732
(6)	Equity securities		—		—
(7)	Unused available lines of credit		—		—
(8)	Unused available letters of credit		—		6,000,000
(9)	Debt service reserve		—		—
(10)	Other – security deposit		—		1,277,290
	Total amount of qualifying assets listed for liquid reserve	(11)	4,584,847	(12)	96,542,033
	Total amount required	(13)	4,584,847	(14)	8,128,650
	Surplus (deficiency)	(15) $	—	(16)	88,413,383

Signature _____ Date 4/29/20

(Authorized representative)

(Title) CFO of CRALP

See accompanying independent auditors' report on supplementary information.