CORECARE III
dba MORNINGSIDE
OF FULLERTON

FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

YEARS ENDED DECEMBER 31, 2018 AND 2017

WITH INDEPENDENT AUDITORS' REPORT

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dba MORNINGSIDE OF FULLERTON
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INDEPENDENT AUDITORS' REPORT

To the Partners of
CoreCare III
dba Morningside of Fullerton
Fullerton, California

We have audited the accompanying financial statements of CoreCare III, dba Morningside of Fullerton (a California limited partnership) (the "Partnership"), which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of operations, comprehensive income, changes in partners' equity (deficit), and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CoreCare III, dba Morningside of Fullerton, as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

White Nelson Diehl Evans LLP

Irvine, California
April 29, 2019

CORECARE III
dba MORNINGSIDE OF FULLERTON
BALANCE SHEETS
DECEMBER 31, 2018 AND 2017

ASSETS

	2018	2017
Current Assets:		
Cash and cash equivalents	$ 3,198,463	$ 5,417,655
Marketable securities	8,013,832	8,239,653
Accounts receivable	113,878	22,952
Inventories	38,451	33,410
Prepaid expenses	253,183	242,622
Interest receivable	-	9,101
Other receivables	4,184	21,349
Temporary loans Master Trust	1,647,048	-
Total Current Assets	13,269,039	13,986,742
Property and Equipment:		
Land	7,642,717	7,642,717
Land improvements	5,695,870	5,685,184
Buildings and improvements	61,539,054	60,931,929
Furniture, fixtures, and equipment	4,268,412	4,080,052
Computer equipment and systems	1,006,016	973,516
Construction in progress	3,623,943	54,717
Total Property and Equipment, at Cost	83,776,012	79,368,115
Less: Accumulated depreciation	(44,196,538)	(42,045,601)
Property and Equipment, at Net Book Value	39,579,474	37,322,514
Other Assets:		
Other receivables, long term	348,122	326,215
Deferred entrance fees receivable	21,518,620	21,498,830
Total Other Assets	21,866,742	21,825,045
Total Assets	$ 74,715,255	$ 73,134,301

The accompanying notes are an integral part of these financial statements.

CORECARE III
dba MORNINGSIDE OF FULLERTON
BALANCE SHEETS (CONTINUED)
DECEMBER 31, 2018 AND 2017

LIABILITIES AND PARTNERS' EQUITY (DEFICIT)

	2018	2017
Current Liabilities:		
Accounts payable	$ 1,218,806	$ 258,274
Accrued expenses	681,624	641,325
Deposits on future occupancy	1,971,974	681,000
Current portion of note payable to Master Trust	3,830,171	3,757,441
Total Current Liabilities	7,702,575	5,338,040
Long-Term Liabilities:		
Note payable to Master Trust, net of current portion	149,774,649	149,931,004
Deferred revenue from unamortized deferred entrance fees, net	20,103,536	19,912,372
Total Long-Term Liabilities	169,878,185	169,843,376
Total Liabilities	177,580,760	175,181,416
Partners' Equity (Deficit):		
Partners' equity (deficit)	(105,201,421)	(105,464,386)
Accumulated other comprehensive income	2,335,916	3,417,271
Total Partners' Equity (Deficit)	(102,865,505)	(102,047,115)
Total Liabilities and Partners' Equity (Deficit)	$ 74,715,255	$ 73,134,301

The accompanying notes are an integral part of these financial statements.

CORECARE III
dba MORNINGSIDE OF FULLERTON
STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Revenues:		
Resident services	$ 23,978,953	$ 22,608,363
Amortization of deferred entrance fees	3,641,491	3,571,198
Deferred entrance fees on terminated contracts	1,507,796	1,701,067
Nonresident services	158,734	202,718
Total Revenues	29,286,974	28,083,346
Operating Expenses:		
Resident care	6,981,059	7,014,998
Food and beverage services	3,348,745	3,186,866
Environmental services	990,950	956,506
Plant facility operating costs	3,726,651	4,145,618
General and administrative expenses	6,090,206	5,282,583
Depreciation	2,169,983	2,105,280
(Gain) loss on disposal of property and equipment	2,516	(500)
Total Operating Expenses	23,310,110	22,691,351
Income from Operations	5,976,864	5,391,995
Other Income (Expense):		
Net realized gain (loss) on sale of marketable securities	(6,994)	223,748
Interest and dividend income	292,675	238,250
Other income	420	1,299
Total Other Income (Expense)	286,101	463,297
Net Income	$ 6,262,965	$ 5,855,292

The accompanying notes are an integral part of these financial statements.

CORECARE III
dba MORNINGSIDE OF FULLERTON
STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Net Income	$ 6,262,965	$ 5,855,292
Other Comprehensive Income (Loss):		
Net unrealized holding gains (losses) arising during the year	(913,847)	1,414,377
Amounts reclassified from accumulated other comprehensive income	(167,508)	(223,804)
Total Other Comprehensive Income (Loss)	(1,081,355)	1,190,573
Comprehensive Income	$ 5,181,610	$ 7,045,865

The accompanying notes are an integral part of these financial statements.

CORECARE III
dba MORNINGSIDE OF FULLERTON
STATEMENTS OF CHANGES IN PARTNERS' EQUITY (DEFICIT)
YEARS ENDED DECEMBER 31, 2018 AND 2017

	General Partner	Limited Partner	Accumulated Other Comprehensive Income	Total Partners' Equity (Deficit)
Balance, December 31, 2016	$ (63,461,952)	$ (33,357,726)	$ 2,226,698	$ (94,592,980)
Distributions	(8,700,000)	(5,800,000)	-	(14,500,000)
Net unrealized holding gains arising during the year	-	-	1,414,377	1,414,377
Amounts reclassified from accumulated other comprehensive income	-	-	(223,804)	(223,804)
Net income	3,513,175	2,342,117	-	5,855,292
Balance, December 31, 2017	(68,648,777)	(36,815,609)	3,417,271	(102,047,115)
Distributions	(3,600,000)	(2,400,000)	-	(6,000,000)
Net unrealized holding losses arising during the year	-	-	(913,847)	(913,847)
Amounts reclassified from accumulated other comprehensive income	-	-	(167,508)	(167,508)
Net income	3,757,779	2,505,186	-	6,262,965
Balance, December 31, 2018	$ (68,490,998)	$ (36,710,423)	$ 2,335,916	$(102,865,505)

The accompanying notes are an integral part of these financial statements.

CORECARE III
dba MORNINGSIDE OF FULLERTON
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Cash Flows from Operating Activities:		
Cash received from residents	$ 28,856,973	$ 27,808,140
Interest and dividend income	292,675	238,250
Other income	420	1,299
Reimbursements for services to nonresidents	158,734	202,718
Cash paid to suppliers and employees	(20,152,382)	(20,894,532)
Net Cash and Cash Equivalents Provided by Operating Activities	9,156,420	7,355,875
Cash Flows from Investing Activities:		
Payments made on purchases of property and equipment	(4,429,459)	(1,780,126)
Proceeds from sale of property and equipment	-	500
Purchases of marketable securities	(1,402,744)	(1,332,352)
Proceeds from redemption of marketable securities	540,216	1,705,914
Net Cash and Cash Equivalents Used in Investing Activities	(5,291,987)	(1,406,064)
Cash Flows from Financing Activities:		
Proceeds from note payable to Master Trust	3,673,816	11,421,367
Payments on note payable to Master Trust	(3,757,441)	(3,668,546)
Distributions to partners	(6,000,000)	(14,500,000)
Net Cash and Cash Equivalents Used in Financing Activities	(6,083,625)	(6,747,179)
Net Decrease in Cash and Cash Equivalents	(2,219,192)	(797,368)
Cash and Cash Equivalents, Beginning of Year	5,417,655	6,215,023
Cash and Cash Equivalents, End of Year	$ 3,198,463	$ 5,417,655

The accompanying notes are an integral part of these financial statements.

CORECARE III
dba MORNINGSIDE OF FULLERTON
STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Reconciliation of Net Income to Net Cash and Cash Equivalents		
Provided by Operating Activities:		
Net Income	$ 6,262,965	$ 5,855,292
Noncash Items Included in Net Income:		
Depreciation	2,169,983	2,105,280
Amortization of deferred entrance fees	(3,641,491)	(3,571,198)
Deferred entrance fees on terminated contracts	(1,507,796)	(1,701,067)
(Gain) loss on disposal of property and equipment	2,516	(500)
Net realized (gain) loss on sale of marketable securities	6,994	(223,748)
Changes in:		
Accounts receivable	(90,926)	9,346
Inventories	(5,041)	(249)
Prepaid expenses	(10,561)	8,298
Interest receivable	9,101	(3,030)
Other receivables	(4,742)	(94,958)
Temporary loans Master Trust	(1,647,048)	-
Deferred entrance fees receivable	5,320,661	5,148,619
Accounts payable	960,532	(415,589)
Accrued expenses	40,299	99,579
Deposits on future occupancy	1,290,974	139,800
Net Cash and Cash Equivalents Provided by Operating Activities	$ 9,156,420	$ 7,355,875
Supplemental Disclosure of Noncash Investing and Financing Activities:		
Deferred entrance fees receivable and deferred revenue from unamortized deferred entrance fees recorded to reflect additional amounts due from resident contributions	$ 5,340,452	$ 5,596,307

The accompanying notes are an integral part of these financial statements.

Note 1: Nature of Business and Summary of Significant Accounting Policies

Nature of Business

CoreCare III, dba Morningside of Fullerton (the "Partnership"), owns and operates a multiuse continuing care retirement community located in Fullerton, California. The Partnership operates under the continuing care concept whereby residents enter into agreements that require payment of a one-time entrance fee and a monthly charge. Generally, these payments will entitle residents to the use and privileges of the facility for life.

Profits and losses for financial statement purposes, distributable cash from operations, and profits and losses for tax purposes are allocated and distributed to the partners in accordance with the Partnership Agreement. The Partnership Agreement also provides for priority distributions, plus an allowance for interest.

Basis of Presentation

The accompanying financial statements are presented using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). References to the "ASC" hereafter refer to the Accounting Standards Codification established by the Financial Accounting Standards Board ("FASB") as the source of authoritative US GAAP.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include the operating cash account of the Partnership, money market accounts, time deposits, certificates of deposit, and all highly liquid debt instruments with maturities of three months or less.

Marketable Securities

Marketable securities held by the Partnership at December 31, 2018 and 2017, are classified in accordance with FASB ASC 320-10, *Investments - Debt and Equity Securities*, as available for sale and stated at their fair market value based on quoted market prices. Realized gains or losses from the sale of marketable securities are computed based on specific identification of historical cost. Unrealized gains or losses of marketable securities are reported as a separate component of partners' equity (deficit) and as a separate component of other comprehensive income (loss).

Note 1: Nature of Business and Summary of Significant Accounting Policies (Continued)

Accounts Receivable

Accounts receivable consist of amounts due from residents for monthly service fees and other ancillary services. These services and fees are primarily due upon receipt of invoice. Receivables are reviewed weekly and are considered past due 14 days after the issuance of monthly statements. Accounts for which no payments have been received for 30 days are considered delinquent, and customary collection efforts are initiated. Uncollectible accounts are written off at the advice of a collection attorney and with the approval of management.

The Partnership provides an allowance for doubtful accounts, as needed based on historical losses, for accounts deemed uncollectible. No allowance was necessary at December 31, 2018 and 2017.

Inventories

Inventories consist of food and supplies used in operations and are stated at the lower of cost or market on a first-in, first-out basis.

Property and Equipment

Property and equipment are stated at cost. Major improvements and betterments are capitalized. Maintenance and repairs are expensed as incurred. Property and equipment are depreciated over the estimated useful lives of the respective assets. Depreciation for property and equipment is computed on the straight-line method for book purposes.

The estimated useful lives of the related assets are as follows:

Land improvements	15-20 years
Buildings and improvements	10-40 years
Furniture, fixtures, and equipment	5-10 years
Computer equipment and systems	3-5 years

Depreciation expense for the years ended December 31, 2018 and 2017, totaled $2,169,983 and $2,105,280, respectively. At December 31, 2018 and 2017, fully depreciated property and equipment still in use totaled $6,046,276 and $5,875,836, respectively.

Long-Lived Assets

The Partnership accounts for impairment and disposition of long-lived assets in accordance with FASB ASC 360-10, *Property, Plant, and Equipment.* FASB ASC 360-10 requires impairment losses to be recognized for long-lived assets used in operations when indicators of impairment are present and the undiscounted future cash flows are not sufficient to recover the assets' carrying amount. There was no impairment of value of such assets for the years ended December 31, 2018 and 2017.

Note 1: Nature of Business and Summary of Significant Accounting Policies (Continued)

Deposits on Future Occupancy

Deposits on future occupancy represent deposits on future contracts from prospective residents that are fully refundable upon demand.

Revenue Recognition

Revenue from resident and nonresident services is accounted for on the accrual basis of accounting as earned. See Note 7 for a description of the revenue recognition policy of deferred entrance fees.

Revenue and Expenses

In accordance with the Residence and Care Agreement (as more fully described in Note 4), future monthly fees due from residents for maintenance and operating expenses may be adjusted with appropriate notice as specified in the individual agreements.

Income Taxes

The Partnership is not taxed on its income. Taxable income or loss is reportable by each of the partners.

Advertising and Promotional Costs

Advertising and promotional costs are charged to operations when incurred. For the years ended December 31, 2018 and 2017, advertising and promotional costs totaled $1,206,536 and $1,049,830, respectively, and are included in general and administrative expenses in the accompanying statements of operations.

Comprehensive Income

Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income. The Partnership has presented separate statements of comprehensive income. An analysis of changes in components of accumulated other comprehensive income is presented in the statements of changes in partners' equity (deficit).

Use of Estimates

The process of preparing financial statements in accordance with US GAAP requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Note 1: Nature of Business and Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncement - Implemented

In October 2018, the FASB issued Accounting Standards Update ("ASU") 2018-17, *Consolidation (Topic 810)*. Under the amendments in this ASU, the Partnership may elect not to apply variable interest entity ("VIE") guidance to legal entities under common control if both entities being evaluated for consolidation are not public business entities. Under the accounting alternative, the Partnership should provide detailed disclosures about its involvement with and exposure to the legal entity under common control. The amendments in this ASU are effective for a private company for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted. The Partnership has elected early adoption of ASU 2018-17.

New Accounting Pronouncements - Pending

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The ASU establishes new revenue recognition guidance ("ASC 606"), which replaces the current revenue recognition guidance. ASC 606 is a comprehensive revenue recognition standard for virtually all industries, including those that previously followed industry-specific guidance, such as the real estate, construction, and software industries. The core principle of ASC 606 is to recognize revenue to depict the transfer of 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. ASC 606 is effective for nonpublic companies for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Partnership is currently evaluating the impact of the provisions of ASC 606 on the presentation of its financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10)*, with subsequent corrections issued in ASU 2018-03. One of the main provisions of this ASU is that it requires investments in equity securities with readily determinable fair values to be measured at fair value, with changes in fair value recognized in earnings. An entity's equity investments that are accounted for under the equity method of accounting or that result in consolidation of an investee are not included within the scope of this ASU. For equity investments that do not have readily determinable fair values, the ASU allows them to be remeasured at fair value either upon the occurrence of an observable price change or upon identification of an impairment, and requires an assessment for impairment qualitatively at each reporting period. ASU 2016-01 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Partnership is currently evaluating the impact of the provisions of ASU 2016-01 on the presentation of its financial statements.

Note 2: Concentrations, Risks, and Uncertainties

The Partnership maintains cash balances with one financial institution. At December 31, 2018 and 2017, accounts at this institution are insured by the Federal Deposit Insurance Corporation ("FDIC") for up to $250,000. The Partnership's deposits in these financial institutions at times exceeded the amount insured by the FDIC. The risk is managed by maintaining deposits in high-quality financial institutions.

At December 31, 2018 and 2017, the Partnership also maintains its money market funds and investments in equity securities at brokerage firms that are not FDIC insured. The firms are insured by the Securities Investor Protection Corporation for up to $500,000.

Note 3: Marketable Securities

At December 31, 2018 and 2017, the Partnership's investments consist primarily of publicly traded equity securities categorized as available-for-sale securities that are stated at fair market value.

At December 31, 2018, cost and fair market value of such investments are as follows:

	Cost	Fair Value	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss
Equities	$ 5,677,916	$ 8,013,832	$ 2,525,918	$ 190,002

At December 31, 2018, the allowance for unrealized gains and losses has been recorded as a separate component of partners' equity (deficit) under accumulated other comprehensive income. At December 31, 2018, the aggregate market value of marketable securities exceeds their aggregate cost by $2,335,916. Other comprehensive income for the year ended December 31, 2018, includes net unrealized holding losses arising during the year of $913,847 and amounts reclassified from accumulated other comprehensive income totaling $167,508. The amounts reclassified from accumulated other comprehensive income affect the net realized loss on the sale of marketable securities in the accompanying statements of operations.

Sales of marketable securities classified as available for sale during the year ended December 31, 2018, resulted in proceeds of $540,216, gross realized gains of $39,334, and gross realized losses of $46,328.

Note 3: Marketable Securities (Continued)

At December 31, 2017, cost and fair market value of such investments are as follows:

	Cost	Fair Value	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss
Equities	$ 4,822,382	$ 8,239,653	$ 3,428,431	$ 11,160

At December 31, 2017, the allowance for unrealized gains and losses has been recorded as a separate component of partners' equity (deficit) under accumulated other comprehensive income. At December 31, 2017, the aggregate market value of marketable securities exceeds their aggregate cost by $3,417,271. Other comprehensive income for the year ended December 31, 2017, includes net unrealized holding gains arising during the year of $1,414,377 and amounts reclassified from accumulated other comprehensive income totaling $223,804. The amounts reclassified from accumulated other comprehensive income affect the net realized gain on the sale of marketable securities in the accompanying statements of operations.

Sales of marketable securities classified as available for sale during the year ended December 31, 2017, resulted in proceeds of $1,705,914, gross realized gains of $280,121, and gross realized losses of $56,373.

Note 4: Residence and Care Agreement

Each new resident enters into a contract with the Partnership called the Residence and Care Agreement (the "Residence Agreement"). The form of the agreement is in conformity with the statutes of the State of California Department of Social Services Continuing Care Contracts Branch. The provisions of the agreement include, but are not limited to, such items as the unit to be occupied, initial monthly fee, amount of contribution to the Master Trust (see Note 5), and methods of cancellation and refunds or contingent repayments subject to resale of the units.

Prior to actual occupancy by the resident, a contribution is required to be deposited with the Master Trust pursuant to the Residence Agreement.

Under the Residence Agreement, the contribution received will be repayable under the following terms and conditions:

(1) Cancellation During the Trial Residence Period - Under California law, there is a probationary period of 90 days after the date of the signed agreement during which either the Partnership or the resident may cancel the agreement with or without cause. Death of the resident during the period will cancel the agreement. In the event of cancellation, the resident shall be entitled to a refund in accordance with California law, which states that the Partnership may deduct from the contribution amount a reasonable fee to cover costs and any charges incurred but not paid.

Note 4: Residence and Care Agreement (Continued)

(2) Cancellation After 90 Days - A resident may cancel his or her agreement at any time after the trial residence period for any reason by giving the Partnership 90 days' written notice. Death of the resident will cancel the agreement. However, if an agreement applies to more than one resident, it will remain in effect after the death of one of the residents and be adjusted as described in the agreement. The Partnership may cancel the agreement at any time after the trial residence period for good cause, upon 90 days' written notice to the resident. Examples of good cause are defined in the Residence Agreement.

Upon termination of the Residence Agreement, the resident or his or her estate will be entitled to a repayment of the contribution less a predetermined percentage and any charges incurred but not paid, as determined by the terms and conditions of the individual agreements. In addition, upon termination of the Residence Agreement after the probationary period of 90 days, the Partnership may be entitled to a Deferred Entrance Fee (a percentage of the resident's contribution amount), as defined in each resident's Residence Agreement.

Note 5: Note Payable to Master Trust and Trust Agreement

The Morningside of Fullerton Master Trust (the "Master Trust") was established to provide protection to the residents of the community by providing them with a vehicle through which they obtain a secured interest in the real property of the Partnership. New residents join in and become grantors under the trust agreement. At December 31, 2018 and 2017, the balance outstanding on the Master Trust note payable was $153,604,820 and $153,688,445, respectively.

A contribution amount, as specified in the Residence Agreement, is made to the Master Trust by the grantor (see Note 4). The trustee of the Master Trust is directed to invest virtually all of the funds in the form of an interest-free loan to the Partnership.

The loan, which currently may not exceed $205,000,000, is secured by the following:

(1) A first priority deed of trust on the Partnership's real property and improvements thereon.

(2) Security agreement creating a first security interest in the Partnership's current and hereafter acquired equity in all of the improvements, fixtures, personal property, and intangible property associated and used in connection with the real property described in the deed of trust.

(3) First priority assignment of contracts including, but not limited to, any residence and care agreement and any management agreement entered into in conjunction with the operation of Morningside of Fullerton.

Note 5: Note Payable to Master Trust and Trust Agreement (Continued)

The security also includes any income generated from and any insurance proceeds recovered from the loss of any property serving as collateral for this loan.

Repayments of principal will be made in annual amounts for a period of 40 years with a final payment due December 31, 2050. Each annual payment or series of payments made during the year shall be equal to or greater than the amount of principal advanced on December 15 next preceding the payment due date divided by 40 years. The next scheduled principal payment of $3,830,171 was paid in January 2019.

Principal payments of the current outstanding Master Trust loan are estimated to mature as follows:

2019	$ 3,830,171
2020	3,703,190
2021	3,610,610
2022	3,520,345
2023	3,432,336
Thereafter	135,508,168
Total	$ 153,604,820

In addition to the annual principal payment, the Partnership provides the Master Trust temporary loans to fund grantor distributions when necessary. These temporary loans are refunded to the Partnership upon subsequent sale of a unit or when the Master Trust has excess liquidity.

Note 6: Commitments and Contingencies

Obligation to Provide Future Services

The Partnership annually calculates the present value of the net cost of future services and use of facilities to be provided to current residents and compares that amount with the present value of monthly service fees and the unamortized deferred revenue from deferred entrance fees. If the present value of the net cost of future services and use of facilities exceeds the monthly service fees and deferred revenue from deferred entrance fees, a liability is recorded.

Using a discount rate of 2.87 percent at December 31, 2018, and a rate of 2.70 percent at December 31, 2017, the anticipated revenues are estimated to exceed the cost of future services by $82,925,792 and $42,393,125 for the years ended December 31, 2018 and 2017, respectively. Therefore, no liability was accrued.

Note 6: Commitments and Contingencies (Continued)

Reservations and Designations

At December 31, 2018 and 2017, the Partnership maintains cash reserves in the amount of $4,311,245 and $4,188,360, respectively, for operating expense contingencies in accordance with the requirements of the California Health and Safety Code under the State of California Department of Social Services. These reserves are included in cash and cash equivalents and marketable securities in the accompanying balance sheets.

Litigation

The Partnership experiences routine litigation in the normal course of its business. Management does not believe that any pending or threatened litigation will have a material adverse effect on its financial statements.

The Partnership is a named party in an ongoing legal matter. The Partnership denies the allegations of the complaints, but in an effort to avoid the inherent risks and significant costs associated with continuing to defend the matter, the Partnership has recorded an estimated loss for its allocated portion of the potential costs to end the litigation, which is expected to be $400,000. This amount is included in accrued expenses in the accompanying balance sheets and the Partnership expects that the amount will be paid in 2019.

Note 7: Deferred Revenue from Unamortized Deferred Entrance Fees

At December 31, 2018 and 2017, deferred revenue from unamortized deferred entrance fees consists of the following:

	2018	2017
Deferred entrance fees before repayment	$ 43,069,562	$ 42,350,505
Less: Accumulated amortization of deferred entrance fees	(22,966,026)	(22,438,133)
Deferred Revenue from Unamortized Deferred Entrance Fees, Net	$ 20,103,536	$ 19,912,372

The deferred entrance fees are amortized to income using the straight-line method over future periods based on the estimated life of the resident in accordance with FASB ASC 954-430, *Health Care Entities - Deferred Revenue.* The period of amortization is adjusted annually based on the actuarially determined estimated remaining life expectancy of each individual or joint and last survivor life expectancy of each pair of residents occupying the same unit. During 2018 and 2017, the deferred entrance fees amortized into income were $3,641,491 and $3,571,198, respectively, based on total deferred entrance fees of $55,045,282 and $53,868,072, respectively.

Note 8: Related-Party Transactions

Pursuant to the provisions of FASB ASU 2018-17, *Consolidation (Topic 810)*, the Partnership has elected to not apply VIE guidance to legal entities under common control. The Partnership is not aware of any exposure to loss as a result of its involvement with these entities.

At December 31, 2018 and 2017, the Partnership has a formal service agreement with a related company concerning the provision of administrative and operational oversight services, including use of brand, transaction processing, and benefit and insurance administration, among others. The service agreement calls for annual service fees payable in equal monthly installments, and the agreement renews annually unless canceled. For the years ended December 31, 2018 and 2017, service fees paid under this agreement totaled \$294,600 and \$287,424, respectively. The service agreement also provides for additional fees for supplemental services and out-of-pocket expenses, as needed. For the years ended December 31, 2018 and 2017, the additional fees paid under this agreement totaled \$102,996 and \$99,920, respectively. Furthermore, the service agreement also provides for insurance premiums to be paid to a related company. Insurance premiums paid under this agreement for the years ended December 31, 2018 and 2017, totaled \$308,246 and \$256,808, respectively.

During the years ended December 31, 2018 and 2017, the Partnership paid \$450,000 annually to the partners for consulting services rendered and administrative expenses incurred to carry out its responsibilities. These expenses are included in general and administrative expenses in the accompanying statements of operations.

The Partnership has entered into a ground lease agreement with CoreCare V, which continues through December 2090. The premises covered by this agreement are the land on which CoreCare V is located. Any failure by CoreCare V to perform under the ground lease agreement or the agreement for purchased health care would permit the Partnership to take ownership of CoreCare V's buildings and equipment and cancel the ground lease.

The health-care costs paid to CoreCare V during the years ended December 31, 2018 and 2017, were \$6,088,383 and \$6,167,987, respectively, and are included in resident care expenses in the accompanying statements of operations.

Note 9: Employee Benefit Plan

The Partnership sponsors a qualified 401(k) plan (the "Plan") for all eligible employees. Employees may contribute up to 80 percent of their yearly compensation, up to the maximum prescribed by law. The Partnership makes a safe harbor matching contribution equal to 100 percent of the first 3 percent of the participant's compensation and 50 percent of the next 2 percent of the participant's compensation, which is deferred as an elective deferral. For the years ended December 31, 2018 and 2017, employer contributions to the Plan totaled \$123,371 and \$110,604, respectively, which have been included in general and administrative expenses in the accompanying statements of operations.

Note 10: Fair Value Measurements

The Partnership accounts for marketable securities in accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*. ASC 820-10 defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures about fair value measurements. FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs in the valuation of an asset as of the measurement date. The three levels are defined as follows:

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

Level 2: Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3: Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Fair value is a market-based measurement considered from the perspective of a market participant rather than an entity-specific measurement. Therefore, even when market assumptions are not readily available, the Partnership's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Assets measured at fair value on a recurring basis are composed of available-for-sale securities. The fair value of the assets at December 31, 2018, is determined as follows:

	Level 1	Level 2	Level 3
Equities:			
Large value	$ 3,663,080	$ -	$ -
Large growth	884,760	-	-
Large core	3,199,952	-	-
Mid value	266,040	-	-
Total Assets at Fair Value	$ 8,013,832	$ -	$ -

Note 10: Fair Value Measurements (Continued)

Assets measured at fair value on a recurring basis are composed of available-for-sale securities. The fair value of the assets at December 31, 2017, is determined as follows:

	Level 1	Level 2	Level 3
Equities:			
Large value	$ 3,458,460	$ -	$ -
Large growth	858,696	-	-
Large core	3,599,777	-	-
Mid value	322,720	-	-
Total Assets at Fair Value	$ 8,239,653	$ -	$ -

Note 11: Subsequent Events

Events occurring after December 31, 2018, have been evaluated for possible adjustment to the financial statements or disclosure as of April 29, 2019, which is the date the financial statements were available to be issued. There were no adjustments to the financial statements or additional disclosures as a result of this evaluation.

SUPPLEMENTARY INFORMATION

WNDE
White Nelson Diehl Evans LLP
CPAs | TAX | ADVISORY | AUDIT

INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTARY INFORMATION

To the Partners of
CoreCare III
dba Morningside of Fullerton
Fullerton, California

We have audited the financial statements of CoreCare III, dba Morningside of Fullerton (the "Partnership") as of and for the years ended December 31, 2018 and 2017, and our report thereon dated April 29, 2019, which expressed an unmodified opinion on those financial statements, appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of Form 5-1 through Form 5-5 and Form 7-1 are prepared for filing with the State of California, Department of Social Services, in accordance with Section 1792 of the California Health and Safety Code, and are presented for purposes of additional analysis and are not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 financial statements as a whole.

This report is intended solely for the information and use of the partners and management of the Partnership and for filing with the California Department of Social Services and should not be used by anyone other than those specified parties. However, this report is a matter of public record and its distribution is not limited.

White Nelson Diehl Evans LLP

Irvine, California
April 29, 2019

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					$0
2					$0
3					$0
4					$0
5					$0
6					$0
7					$0
8					$0
		TOTAL:	$0	$0	$0

(Transfer this amount to Form 5-3, Line 1)

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

*Pursuant to the attached waiver, the note payable to Master Trust has not been included in the annual calculation of the debt service reserve.

PROVIDER: CoreCare III

STATE OF CALIFORNIA—HEALTH & HUMAN SERVICES AGENCY GRAY DAVIS, *Governor*

DEPARTMENT OF SOCIAL SERVICES
744 P Street, MS 10-90, Sacramento, California 95814

July 30, 2003

Mr. E. Justin Wilson III
Executive Vice President
CoreCare III
800 Morningside Drive
Fullerton, California 92835

Re: Waiver Request under H&S Code Section 1792.3(c)

Dear Mr. Wilson:

The Department of Social Services has reviewed your request that it waive the long term debt reserve requirement as it applies to the debt held by the Morningside of Fullerton Master Trust (the "Trust"). Your request on behalf of CoreCare III is made on the basis of the provisions in Health & Safety Code section 1792.3(c).

Based on our review of your request and the information in our files, the Department has granted your request. As a result, CoreCare III need not include the debt owed to the Trust in the annual calculation of its debt service reserve. This waiver remains effective until the Department, in its discretion, determines that it is terminated. Please include a copy of this letter with CoreCare III's future annual reserve reports.

If you have any questions, please contact me at (916) 657-2592.

Respectfully,

Ben Partington

Ben Partington, Chief
Continuing Care Contracts Branch
Department of Social Services

C: Robert W. Thompson, Legal Counsel

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) x (d))
1		$0	$0	0	$0
2					$0
3					$0
4					$0
5					$0
6					$0
7					$0
8					$0
	TOTAL:	$0	$0	0	$0

(Transfer this amount to Form 5-3, Line 2)

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

PROVIDER: CoreCare III

FORM 5-3
CALCULATION OF LONG-TERM DEBT RESERVE AMOUNT

Line		TOTAL
1	Total from Form 5-1 bottom of Column (e)	$0
2	Total from Form 5-2 bottom of Column (e)	$0
3	Facility leasehold or rental payment paid by provider during fiscal year (including related payments such as lease insurance)	
4	**TOTAL AMOUNT REQUIRED FOR LONG-TERM DEBT RESERVE:**	$0

PROVIDER: CoreCare III

FORM 5-4
CALCULATION OF NET OPERATING EXPENSES

Line			Amounts	TOTAL Year Ended 12/31/2018
1		Total operating expenses from financial statements		$23,310,110
2		Deductions:		
	a.	Interest paid on long-term debt (see instructions)		
	b.	Credit enhancement premiums paid for long-term debt (see instructions)		
	c.	Depreciation	$2,169,983	
	d.	Amortization		
	e.	Revenues received during the fiscal year for services to persons who did not have a continuing care contract	$158,734	
	f.	Extraordinary expenses approved by the Department		
3		Total Deductions		$2,328,717
4		Net Operating Expenses		$20,981,393
5		Divide Line 4 by 365 and enter the result.		$57,483
6		**Multiply Line 5 by 75 and enter the result.** This is the provider's operating expense reserve amount.		$4,311,245

PROVIDER: CoreCare III
COMMUNITY: Morningside of Fullerton

FORM 5-4
CALCULATION OF NET OPERATING EXPENSES
Supporting Explanation for Line 2e

Line 2e is made up of the following lines from the audited statement of cash flows:

Reimbursements for services to non-residents	$ 158,734
Revenues received during the fiscal year for services to residents who did not have a continuing care contract	$ 158,734

Categories included in the above revenues:

$ 54,433	Employee Meals
21,263	Guest Meals
12,726	Catering
28,947	Processing Fees
41,365	Guest Room
$ 158,734	

PROVIDER: CoreCare III
COMMUNITY: Morningside of Fullerton

FORM 5-5
ANNUAL RESERVE CERTIFICATION

Provider Name: CoreCare III
Fiscal Year Ended: 12/31/2018

We have reviewed our debt service reserve and operating expense reserve requirements as of, and for the period ended 12/31/2018 and are in compliance with those requirements.

Our liquid reserve requirements, computed using the audited financial statements for the fiscal year 12/31/2018 are as follows:

		Amount
[1]	Debt Service Reserve Amount	$0
[2]	Operating Expense Reserve Amount	$4,311,245
[3]	**Total Liquid Reserve Amount:**	$4,311,245

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		Operating Reserve
[4]	Cash and Cash Equivalents			$3,198,463
[5]	Investment Securities			$8,013,832
[6]	Equity Securities			
[7]	Unused/Available Lines of Credit			
[8]	Unused/Available Letters of Credit			
[9]	Debt Service Reserve			(not applicable)
[10]	Other: (describe qualifying asset)			
	Total Amount of Qualifying Assets Listed for Reserve Obligation: [11]	$0	[12]	$11,212,295
	Reserve Obligation Amount: [13]	$0	[14]	$4,311,245
	Surplus/(Deficiency): [15]	$0	[16]	$6,901,050

NOTE: Please find attached the debt service requirement waiver.

Signature:
E. Justin Wilson, III
Chief Executive Officer

Date: 4/26/2019

FORM 5-5
Description of Reserves under SB 1212

Total Qualifying Assets as Filed:

Cash and Cash Equivalents	$	3,198,463
Investment Securities	$	8,013,832
Total Qualifying Assets as Filed	$	11,212,295

Reservations and Designations:

Reserved for Debt Service	$	-
Reserved for Operating Expenses	$	4,311,245
Total Reservations and Designations	$	4,311,245
Remaining Liquid Reserves	$	6,901,050

Per Capita Cost of Operations

		12 Months Ending 12/31/18
Operating Expenses (Form 5-4 line #1)	$	23,310,110
Mean # of CCRC Residents (Form 1-1 line 10)		480
Per Capita Cost of Operations	$	48,563

NOTE: Operating expenses shown above are for the period of January 1, 2018 to December 31, 2018

PROVIDER: CoreCare III
COMMUNITY: Morningside of Fullerton

FORM 7-1

REPORT ON CCRC MONTHLY SERVICE FEES

		RESIDENTIAL LIVING	ASSISTED LIVING	SKILLED NURSING
[1]	Monthly Service Fees at beginning of reporting period: (indicate range, if applicable)	**$3,044 – $6,428**	**N/A**	**N/A**
[2]	Indicate percentage of increase in fees imposed during reporting period: (indicate range, if applicable)	**3.6%**	**N/A**	**N/A**

☐ Check here if monthly service fees at this community were not increased during the reporting period. (If you checked this box, please skip down to the bottom of this form and specify the names of the provider and community.)

[3] Indicate the date the fee increase was implemented: _______January 1, 2018_______
(If more than 1 increase was implemented, indicate the dates for each increase.)

[4] Check each of the appropriate boxes:

☒ Each fee increase is based on the provider's projected costs, prior year per capita costs, and economic indicators.

☒ All affected residents were given written notice of this fee increase at least 30 days prior to its implementation.

☒ At least 30 days prior to the increase in monthly service fees, the designated representative of the provider convened a meeting that all residents were invited to attend.

☒ At the meeting with residents, the provider discussed and explained the reasons for the increase, the basis for determining the amount of the increase, and the data used for calculating the increase.

☒ The provider provided residents with at least 14 days advance notice of each meeting held to discuss the fee increases.

☒ The governing body of the provider, or the designated representative of the provider posted the notice of, and the agenda for, the meeting in a conspicuous place in the community at least 14 days prior to the meeting.

[5] On an attached page, provide a concise explanation for the increase in monthly service fees including the amount of the increase.

PROVIDER: CoreCare III
COMMUNITY: Morningside of Fullerton

FORM 7-1
REPORT ON CCRC MONTHLY SERVICE FEES
Supporting Explanation for Line 5

The monthly fee increase for 2018 is reflected at 3.6%. The cost drivers for this increase are: minimum wage, raw food cost – 4.5%, Employee Health Insurance Increase – 9%; General Insurance Increase – 3% for GL/PL, property, auto, cyber, crime; Workers Comp; Ancillary Expenses – ranges of 3%; Purchased Health Care (driven by 5% increase in cost). These figures were arrived at by using economic indicators and estimating future cost increases, which information was derived from suppliers, government mandate, and industry periodicals. The budgeted NOI, which is basically flat with the prior year's budget, does not include capital expenditures, which are estimated at $2.5 million. Economic indicators driving these capital projects include the updating of residences that turnover in order to keep current with market expectations. Other capital projects include: HVAC Boilers, Replace gutters and downspouts, Paint exterior buildings (Canyonside, Mountainside, Gardenside), Update elevator controls and finishes, Clubhouse Furniture, new LED lights (Clubhouse, Commons Kitchen, and Outdoor), Replacing kitchen ceiling tiles/grides, Remodeling the Marketing offices. These projects, and future projects that economic indicators may require, will be paid from future cash flow. NOI surplus will also be used as a return to owners for the risk of operating the community.

PROVIDER: CoreCare III
COMMUNITY: Morningside of Fullerton