LEXINGTON RETIREMENT COMMUNITY, INC.
(D/B/A KENDAL AT LEXINGTON)

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

LEXINGTON RETIREMENT COMMUNITY, INC.
(D/B/A KENDAL AT LEXINGTON)
TABLE OF CONTENTS
YEARS ENDED DECEMBER 31, 2016 AND 2015

CliftonLarsonAllen LLP
CLAconnect.com

INDEPENDENT AUDITORS' REPORT

Audit and Oversight Committee
Lexington Retirement Community, Inc.
(d/b/a Kendal at Lexington)
Lexington, Virginia

Report on Financial Statements

We have audited the accompanying financial statements of Lexington Retirement Community, Inc. (d/b/a Kendal at Lexington), which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of operations, changes in net assets (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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

A member of Nexia International

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lexington Retirement Community, Inc. (d/b/a Kendal at Lexington) as of December 31, 2016 and 2015, and the results of its operations, changes in net assets (deficit), and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, Lexington Retirement Community, Inc. adopted a recently issued accounting standard related to the accounting for debt issuance costs. The new standard requires entities to present debt issuance costs as a direct deduction from the face amount of the related borrowings, amortize debt issuance costs using the effective interest rate method over the life of the debt, and record the amortization as a component of interest expense. Our opinion is not modified with respect to this matter.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Plymouth Meeting, PA
April 20, 2017

LEXINGTON RETIREMENT COMMUNITY, INC.
(D/B/A KENDAL AT LEXINGTON)
BALANCE SHEETS
DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 886,720	$ 529,335
Accounts Receivable, Net of Allowance for Doubtful Accounts of $224,052 in 2016 and $232,705 in 2015	659,673	638,500
Contributions Receivable and Other	149,745	10,000
Entry Fee Receivable	646,850	1,296,375
Prepaid Expenses and Other	270,131	237,213
Current Portion of Assets Limited as to Use	265,740	1,546,300
Total Current Assets	2,878,859	4,257,723
INVESTMENTS	16,286,119	14,886,536
ASSETS LIMITED AS TO USE		
By Trustee under Bond Indenture	2,052,246	4,050,755
By Board	804,560	763,654
Escrowed Deposits	359,300	152,500
By Donors	1,461,659	1,085,341
Total	4,677,765	6,052,250
Less: Current Portion of Assets Limited as to Use	(265,740)	(1,546,300)
Total Assets Limited as to Use	4,412,025	4,505,950
PROPERTY AND EQUIPMENT		
Land	824,971	824,971
Buildings and Improvements	52,592,737	52,070,524
Equipment and Furniture	3,940,918	3,879,139
Construction In Progress	1,361,598	350,826
Total	58,720,224	57,125,460
Less: Accumulated Depreciation	(21,963,136)	(20,029,014)
Property and Equipment, Net	36,757,088	37,096,446
OTHER ASSETS		
Contributions Receivable	327,455	-
Deferred Marketing Costs, Net of Accumulated Amortization of $466,718 in 2016 and $413,882 in 2015	181,209	220,188
Insurance Deposits	317,642	311,440
Beneficial Interest in Charitable Remainder Unitrust Receivable	17,075	14,616
Total Other Assets	843,381	546,244
Total Assets	$ 61,177,472	$ 61,292,899

See accompanying Notes to Financial Statements.

LIABILITIES AND NET ASSETS	2016	2015
CURRENT LIABILITIES		
Current Portion of Long-Term Debt	$ 20,000	$ 710,000
Accounts Payable and Accrued Expenses	888,104	771,337
Accrued Interest Payable	245,740	836,300
Due to The Kendal Corporation	5,691	22,158
Entry Fee Refund Payable	-	18,990
Total Current Liabilities	1,159,535	2,358,785
LONG-TERM LIABILITIES		
Long-Term Debt, Net of Current Portion	29,373,992	29,350,115
Deferred Entrance Fee Revenue	27,747,967	27,928,828
Refundable Contract Obligations	479,520	479,520
Entry Fee Deposits	359,300	152,500
Total Long-Term Liabilities	57,960,779	57,910,963
Total Liabilities	59,120,314	60,269,748
NET ASSETS (DEFICIT)		
Unrestricted	(693,337)	(840,460)
Unrestricted-Board Designated	804,560	763,654
Total Unrestricted	111,223	(76,806)
Temporarily Restricted	1,661,581	820,675
Permanently Restricted	284,354	279,282
Total Net Assets	2,057,158	1,023,151
Total Liabilities and Net Assets	$ 61,177,472	$ 61,292,899

LEXINGTON RETIREMENT COMMUNITY, INC.
(D/B/A KENDAL AT LEXINGTON)
STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
REVENUE		
Net Residential Services Revenue	$ 6,214,462	$ 5,866,717
Health Center Fees	6,028,891	6,117,878
Amortization of Deferred Entry Fees	2,564,493	2,746,629
Investment Income	724,141	635,642
Contributions	260	520
Other Income	327,577	346,109
Net Assets Released from Restrictions	35,762	33,312
Total Revenue	15,895,586	15,746,807
OPERATING EXPENSES		
General and Administrative	1,694,217	1,511,442
Housekeeping and Laundry	307,752	302,601
Maintenance	885,276	784,447
Food Service	1,558,567	1,492,551
Health Service	3,983,597	3,951,838
Employee Benefits	1,363,838	1,173,290
Utilities	609,644	619,382
Real Estate Taxes	216,582	204,236
Affiliation and Service Fee	489,359	479,904
Interest Expense	1,666,798	1,739,752
Depreciation and Amortization	2,031,438	1,976,227
Provision for Bad Debt Expense	15,815	177,457
Total Operating Expenses	14,822,883	14,413,127
INCOME FROM OPERATIONS	1,072,703	1,333,680
NON-OPERATING LOSS		
Loss on Extinguishment of Long-Term Debt	(979,159)	-
Loss on Disposal of Property and Equipment	(9,702)	(3,816)
Total Non-Operating Loss	(988,861)	(3,816)
EXCESS OF REVENUE OVER EXPENSES	$ 83,842	$ 1,329,864

See accompanying Notes to Financial Statements.

LEXINGTON RETIREMENT COMMUNITY, INC.
(D/B/A KENDAL AT LEXINGTON)
STATEMENTS OF CHANGES IN NET ASSETS (DEFICIT)
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
UNRESTRICTED NET DEFICIT		
Excess of Revenue Over Expenses	$ 83,842	$ 1,329,864
Unrealized Gain (Loss) on Investments	101,426	(422,684)
Net Assets Released from Restrictions Used for Purchase of Property and Equipment	2,761	35,722
Increase in Unrestricted Net Assets	188,029	942,902
TEMPORARILY RESTRICTED NET ASSETS		
Contributions	828,217	161,724
Investment Income	48,753	10,734
Change in the Beneficial Interest in Charitable Remainder Unitrust Receivable	2,459	(130)
Net Assets Released from Restrictions Used for Purchase of Property and Equipment	(2,761)	(35,722)
Net Assets Released from Restrictions Used for Operations	(35,762)	(33,312)
Increase in Temporarily Restricted Net Assets	840,906	103,294
PERMANENTLY RESTRICTED NET ASSET CONTRIBUTIONS	5,072	1,232
INCREASE IN NET ASSETS	1,034,007	1,047,428
Net Assets (Deficit) - Beginning of Year	1,023,151	(24,277)
NET ASSETS - END OF YEAR	$ 2,057,158	$ 1,023,151

See accompanying Notes to Financial Statements.

LEXINGTON RETIREMENT COMMUNITY, INC.
(D/B/A KENDAL AT LEXINGTON)
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in Net Assets	$ 1,034,007	$ 1,047,428
Adjustments to Reconcile Increase in Net Assets to Cash Flows Provided by Operating Activities:		
Loss on Disposals of Property and Equipment	9,702	3,816
Restricted Contributions	(5,072)	(1,232)
Unrealized and Realized (Gain) Loss on Investments and Assets Limited As to Use	(407,564)	148,705
Depreciation and Amortization of Deferred Marketing Costs	2,031,438	1,976,227
Amortization of Deferred Financing Costs	38,520	51,360
Loss on Extinguishment of Debt	979,159	-
Entry Fee Amortization	(2,564,493)	(2,746,629)
Deferred Entry Fees Received	3,220,967	3,019,220
Amortization of Original Issue Discount	11,844	15,792
(Increase) Decrease in:		
Accounts Receivables, Net	(21,173)	50,128
Contributions Receivable and Other	(469,659)	130
Prepaid Expenses and Other	(32,918)	(50,443)
Increase (Decrease) in:		
Accounts Payable and Accrued Expenses	116,767	203,603
Accrued Interest Payable	(1,023,197)	(18,900)
Due to Kendal Corporation	(16,467)	11,171
Net Cash Provided by Operating Activities	2,901,861	3,710,376
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property and Equipment	(1,648,946)	(1,299,219)
Outlay for Deferred Marketing Costs	(13,857)	-
Net Purchases of Investments	(992,019)	(1,658,205)
Deposit of Self Insurance	(6,202)	(44,627)
Decrease in Assets Limited As to Use	1,374,485	112,240
Net Cash Used by Investing Activities	(1,286,539)	(2,889,811)
CASH FLOWS FROM FINANCING ACTIVITIES		
Restricted Contributions	5,072	1,232
Payments for Debt Issuance Costs	(581,798)	-
Proceeds from Issuance of Debt	29,975,790	-
Repayment of Long-Term Debt	(30,657,001)	(675,000)
Net Cash Used by Financing Activities	(1,257,937)	(673,768)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	357,385	146,797
Cash and Cash Equivalents - Beginning of Year	529,335	382,538
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 886,720	$ 529,335

See accompanying Notes to Financial Statements.

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Lexington Retirement Community, Inc. ("LRC") or (the "Corporation") was formed March 16, 1995 as a Virginia non-stock corporation for the purpose of establishing, maintaining, operating, and managing a continuing care retirement community in Lexington, Virginia. LRC is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code.

Effective March 11, 1997, LRC amended its bylaws for the purpose of affiliating with The Kendal Corporation, a Pennsylvania nonprofit organization. Certain activities of LRC require the approval of The Kendal Corporation. The amended bylaws specify the composition of LRC's Board of Directors and create authority for a residents' association. LRC has registered the trade name *"Kendal at Lexington"* with the Commonwealth of Virginia.

In July 2000, LRC commenced operations. LRC consists of 120 independent living residences in cottages, cottage clusters, and apartments, plus an assisted living facility for 20 residents.

Effective September 6, 2001, LRC became the sole member of Lexington Health Investors, LLC (LHI). LHI was a Virginia limited liability company whose purpose was to operate a 60 bed nursing facility on approximately 2 acres of land, which was transferred by LRC. LHI was exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code. LHI financed the construction of the facility, which began in September 2001 and was completed in September 2002, through a loan from a local hospital as well as a tax-exempt bond issue. LRC was the sole member of LHI. On December 31, 2009, LHI dissolved and all assets, liabilities, and net assets were transferred to LRC.

Use of Estimates

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

Cash and Cash Equivalents

The Corporation considers cash and cash equivalents to include all highly liquid investments with maturities of three months or less.

Allowance for Doubtful Accounts

The Corporation provides an allowance for uncollectible accounts using management's estimate about the collectibility of past due accounts. Residents are not required to provide collateral for services rendered. Payment for services is required upon receipt of invoice or claim submitted. Accounts past due more than 30 days are individually analyzed for collectibility. When all collection efforts have been exhausted, the accounts are written off against the related allowance. Management believes that the allowance for doubtful accounts is adequate to provide for estimated uncollectible accounts associated with the accounts receivable balances.

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Entry Fee Receivable

Entry fee receivable represents entrance fees that are deferred for up to 12 months after a resident occupies a unit. The receivable is expected to be collected during the next twelve months and is, therefore, categorized as a current asset as of December 31, 2016 and 2015. Management determined that no allowance is necessary on the entry fee receivable.

Investments

Investments are comprised primarily of mutual funds, equity securities and debt securities and are measured at fair value in the balance sheets. Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities. Investment income, including interest and dividends, declines in market value deemed to be other than temporary and earnings on trustee held funds, are reported as investment income and included in the deficiency of revenue over expenses. The cost of substantially all securities sold is based on the specific identification method. Unrealized gains are excluded from the excess of revenue over expenses.

Investments are exposed to various risks, such as interest rate, market and credit risks. Due to the risk associated with certain investments, it is reasonably possible that changes in the value of the investments will occur in the near term and that such changes could materially affect the amounts reported in the balance sheet.

Assets Limited as to Use

Assets limited as to use include assets held by trustees under bond indenture agreements, escrowed deposits, and certain donor restricted assets. In addition, unrestricted resources designated by the Corporation’s Board for the Fellowship Fund and Employee Education Fund are reported as assets limited as to use. Assets limited as to use are carried at fair value. Certain amounts required for obligations classified as current liabilities are reported in current assets.

The Corporation’s Board has designated a portion of cash and investments for specific purposes, which include future capital replacements and repairs, fellowship assistance, refunds of deposits from prospective residents, and other general purposes. The Corporation’s Board retains control of these assets and may at its discretion subsequently use the funds for other purposes.

Concentration of Credit Risk

The Corporation maintains its cash accounts at commercial banks. The balances are insured by the Federal Deposit Insurance Corporation (FDIC) up to certain limits. At times, cash in the bank may exceed FDIC insurable limits. The funds on deposit in brokerage accounts are insured by the SIPC up to $500,000.

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and Equipment

The Corporation capitalizes all expenditures for property and equipment with costs over $1,000 and an estimated life greater than one year. The cost of maintenance and repairs are charged against operations as incurred. Property and equipment is stated at cost or at fair value at the date of donation. Depreciation of office furniture and equipment is computed using the straight-line method over estimated useful lives ranging from three to twenty years. Buildings and improvements are depreciated on a straight-line basis over three to forty years. Depreciation expense was $1,978,602 and $1,923,391 for the years ended December 31, 2016 and 2015, respectively.

Deferred Marketing Costs

Direct marketing costs of acquiring initial continuing care contracts, including an allocable marketing portion of the costs incurred under the development and marketing contract with The Kendal Corporation, are capitalized. These costs are amortized over the average estimated life expectancy of the initial residents (twelve years) beginning at the date of initial occupancy. Amortization expense was $52,836 for both of the years ended December 31, 2016 and 2015.

Net Assets (Deficit)

The Corporation reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted (subject to donor or time restrictions), and permanently restricted (principal maintained in perpetuity).

Temporarily restricted net assets are net assets whose use has been limited by donors to a specific purpose. These amounts are principally restricted to resident care and for acquisition or construction of property and equipment. Gifts are reported as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations and changes in net assets (deficit) as net assets released from restrictions.

Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity.

Deferred Entrance Fee Revenue

Non-refundable entry fees paid by residents pursuant to a continuing care contract are recorded as deferred revenue and amortized into operating revenue over the actuarially determined life expectancy of each resident or couple, adjusted annually. Upon death of a sole surviving resident, any remaining unamortized portion of the entry fee is recognized as revenue.

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deferred Entrance Fee Revenue (Continued)

A resident may terminate their contract at any time during the first 90 days, without notice. After that, 30 days' notice is required. In both instances, the paid entry fee is decreased by 2% per month. Amounts refundable are equal to the original fee paid less 2% for each month of occupancy. At December 31, 2016 and 2015, the portion of deferred entry fee revenue subject to such refund provisions amounted to approximately $6,828,000 and $7,291,000, respectively.

Other contracts include a 50% and a 90% refundable option upon the death of the resident or upon termination by the resident. Refunds are payable once the resident's unit is reoccupied. Refundable amounts under these contracts are not amortized to revenue.

Obligation to Provide Future Services

The Corporation annually calculates the present value of the net cost of future services and the use of facilities to be provided to current residents and compares that amount with the balance of deferred entry fee revenue. If the present value of the net cost of future services and the use of facilities exceeds the deferred entry fee revenue, a liability is recorded (obligation to provide future services and use of facilities) with the corresponding charge to income. The obligation is discounted at 5.5% in 2016 and 2015, based on the expected long-term rate of return on investments. Increases or decreases in the obligation are charged or credited to operations, respectively. This calculation did not result in a liability as of December 31, 2016 and 2015.

Charitable Gift Annuities

The Corporation receives assets from donors under gift annuity agreements in exchange for a promise to pay a fixed amount during the annuitant's or specified beneficiary's life. Assets received are recorded at fair value, and a liability is recognized for the present value of future cash flows expected to be paid to the donor. Contribution revenue is recognized for the difference between these amounts. Adjustments to the annuity liability are made annually to reflect changes in the discount rate and the life expectancies of the donors. As of December 31, 2016 and 2015, the Corporation was not the beneficiary of charitable gift annuities.

Charitable Remainder Unitrust

The Corporation is the beneficiary of one charitable remainder unitrust. Each year the trustees pay the recipients during the recipient's life an annuity amount. Upon the death of the recipient, the trustee will distribute the principal and income of the trust. The trust requires the Corporation to use the principal and income for a specified purpose.

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Excess of Revenues over Expenses

The statement of operations and changes in net assets (deficit) include the excess of revenues over expenses which represent all unrestricted revenues and expenses with the exception of other changes in unrestricted net deficit. Other changes in unrestricted net assets include unrealized gains (losses) on investments and net assets released from restrictions used for purchase of property and equipment.

Net Residential Services Revenue

Residential services revenue is recorded at established rates with vacancies and absence allowances deducted to arrive at net residential services revenue. Monthly residential occupancy fees are recognized as revenue in the month of assessment.

Health Care Services Revenue

Health care services rendered to Medicare and Medicaid program beneficiaries are reimbursed at prospectively determined rates. The Corporation is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by Medicare and Medicaid.

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

The Corporation’s health service revenues from the Medicare and Medicaid programs, as a percent of total health service revenues, were approximately 29% and 26% for the year ended December 31, 2016 and 29% and 24% for the year ended December 31, 2015, respectively.

Professional Liability Insurance

The Corporation’s professional liability insurance is on the claims made basis.

Income Taxes

The Corporation has been granted exempt status relative to federal and state corporate income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state codes. The Corporation follows the guidance in the income tax standard regarding the recognition and measurement of uncertain tax positions. The guidance clarifies the accounting for uncertainty in income taxes recognized in an entity’s financial statements. The guidance further prescribes recognition and measurement of tax provisions taken or expected to be taken on a tax return that are not certain to be realized. The application of this standard has no impact on the Corporation’s financial statements.

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Change in Accounting Policies

The Corporation has adopted the accounting guidance in FASB Accounting Standards Update (ASU) No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs.* ASU 2015-03 requires organizations to present debt issuance costs as a direct deduction from the face amount of the related borrowings, amortize debt issuance costs using the effective interest method over the life of the debt, and record amortization as a component of interest expense. The effect of adopting the new standard eliminated the separate presentation of debt issuance costs as an asset. The adoption of the standard has no effect on previously reported net assets. The ASU is retrospectively applied. The Corporation has elected to adopt this change in accounting principle as of January 1, 2015.

During the year ended December 31, 2016, the Corporation adopted a provision of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities.* This provision eliminates the requirement for entities, other than public business entities, to disclose the fair values of financial instruments carried at amortized costs, as previously required by Accounting Standards Codification (ASC) 825-10-50. As such, the Corporation has omitted this disclosure for the years ended December 31, 2016 and 2015. The adoption of this provision did not have an impact on the Corporation’s financial position or results of operations.

Subsequent Events

In preparing these financial statements, the Corporation has evaluated events and transactions for potential recognition or disclosure through April 20, 2017, the date the financial statements were issued.

NOTE 2 RELATED PARTY TRANSACTIONS

The Corporation is affiliated with The Kendal Corporation, a not-for-profit Pennsylvania corporation, through bylaws and the signing of an *Agreement Between The Kendal Corporation and its Affiliates: Mutual Expectations, System Services, and Financial Understandings*. The agreement calls for the Corporation to pay The Kendal Corporation a “System Fee.” The System Fee has three components: a Base System Fee, a Contingency Reserve, and a System Growth Fund Reserve.

The Kendal Corporation must approve the selection of new board members of the Corporation, amendments to the articles of incorporation, and specific sections of the bylaws of the Corporation, as well as, the incurrence of debt of specified value; changes in corporate purpose; use of the name “Kendal”; the substance of resident contracts; and the purchase, sale, lease, or other disposition of any real estate or improvements thereon of a specific value; and dissolution, merger with another entity, division, or acquiring control of another entity.

NOTE 2 RELATED PARTY TRANSACTIONS (CONTINUED)

The Base System Fee is calculated based on budgeted expenses less the System Fee itself, with a minimum fee payment for expenses less than five million, and a percentage for expenses between five million and fifteen million (3%), fifteen million to twenty-five million (2.8%), and over twenty-five million (2.5%).

The Contingency Reserve and System Growth Fund Reserve are each 0.25% of budgeted operating expenses, less the System Fee itself. Each of the reserves has a specific target the Corporation will pay. When the target is met, the System Fee will be decreased accordingly. Kendal at Lexington met the target for the System Growth Fund Reserve in 2013. For the years ended December 31, 2016 and 2015, the Corporation paid a total of $489,359 and $479,904, respectively, under the terms of this agreement.

The Corporation bylaws also specify that the President of The Kendal Corporation, or his/her designee, shall be entitled to attend and speak at all board meetings, but shall not otherwise be part of the consensus.

NOTE 3 ENTRY FEE DEPOSITS

As of December 31, 2016 and 2015, some prospective residents have paid an entry fee deposit, signed a Residency Agreement, and selected a unit. These deposits (which are refundable if the prospective resident does not move in) are held in escrow and are reflected in the financial statements as assets limited as to use. Under the terms of the escrow agreement, interest on these deposits is the property of the Corporation and is recorded as investment income by the Corporation when earned. Upon individual occupancies, deposits will be released from escrow and recorded as deferred entry fee revenue on the balance sheets.

NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE

Investments, recorded at fair value, are summarized by type of investment as follows:

	2016		2015	
	Fair Value	Cost	Fair Value	Cost
Cash and Cash Equivalents	$ 3,863,617	$ 3,863,617	$ 3,506,843	$ 3,506,843
Mutual Funds	12,422,001	12,017,766	9,839,135	9,539,209
U.S. Government Securities	-	-	581,485	582,605
Corporate Bonds	-	-	462,274	470,376
Equities	501	516	496,799	447,198
Total	$ 16,286,119	$ 15,881,899	$ 14,886,536	$ 14,546,231

NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE (CONTINUED)

Assets limited as to use, recorded at fair value, are summarized by type of investment as follows:

	2016		2015	
	Fair Value	Cost	Fair Value	Cost
Cash and Cash Equivalents	$ 2,411,546	$ 2,411,546	$ 4,508,094	$ 4,508,094
Mutual Funds	2,266,219	2,266,219	1,544,156	1,544,156
Total	$ 4,677,765	$ 4,677,765	$ 6,052,250	$ 6,052,250

The composition of assets limited as to use is as follows:

	2016	2015
Held by Trustee for Debt Service Reserve	$ 2,038,838	$ 2,429,014
Held by Trustee for Bond Principal and Interest	13,408	1,621,741
Board-Designated Funds	804,560	763,654
Escrowed Deposits for Entry Fees	359,300	152,500
By Donors	1,461,659	1,085,341
Total	$ 4,677,765	$ 6,052,250

Investment income from investments and assets limited as to use is as follows:

Unrestricted:	2016	2015
Dividends and Interest Income, Net of Fees	$ 438,683	$ 352,479
Net Realized Gains on Investments	285,458	283,163
Total	$ 724,141	$ 635,642
Net Unrealized Gain (Loss) on Investments	$ 101,426	$ (422,684)
Temporarily Restricted:		
Dividends and Interest Income, Net of fees	$ 28,073	$ 19,918
Net Realized Gain on Investments	11,523	78,976
Net Unrealized Gain (Loss) on Investments	9,157	(88,160)
Total	$ 48,753	$ 10,734

The Corporation performs due diligence on the valuation of their investments. The Corporation reviews its portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Management considers in this evaluation factors such as general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of its investment advisors, and the length of time and extent to which the market value has been less than cost, and the ability and intent of the Corporation to hold investments in the long term.

For the years ended December 31, 2016 and 2015 management does not believe that the declines in the market value of investments are considered other-than-temporary.

NOTE 5 TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily Restricted Net Assets

Temporarily restricted net assets are comprised of the following:

	2016	2015
Health Centers Renovations	$ 369,422	$ -
Contributions Receivable	484,275	14,616
Resident Financial Assistance (Fellowship Fund)	779,659	703,948
Other	28,225	102,111
Total	$ 1,661,581	$ 820,675

Permanently Restricted Net Assets

Permanently restricted net assets consist of contributions that have been restricted by the donor that stipulate the investments be maintained in perpetuity. The income from the investments is expendable to support the Fellowship Fund and Employee Education and Development Fund of the Corporation.

Interpretation of Relevant Law

The Commonwealth of Virginia adopted the Uniform Prudent Management of Institutional Funds Act (the Act) effective during 2008. The board of directors of the Corporation has interpreted the Act as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Corporation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Corporation in a manner consistent with the standard of prudence prescribed in the Act. In accordance with the Act, the Corporation considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Corporation and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Corporation
- The investment policy of the Corporation

NOTE 5 TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (CONTINUED)

Interpretation of Relevant Law (Continued)

The following were the changes in the endowment net assets for the years ended December 31, 2016 and 2015:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, December 31, 2014	$ -	$ 86,236	$ 278,050	$ 364,286
Contributions	-	-	1,232	1,232
Investment Income, Net of Fees	-	7,087	-	7,087
Net Appreciation Realized and Unrealized Losses, Net	-	(3,268)	-	(3,268)
Endowment Net Assets, December 31, 2015	-	90,055	279,282	369,337
Contributions	-	-	5,072	5,072
Investment Income, Net of Fees	-	8,570	-	8,570
Net Appreciation Realized and Unrealized Gains, Net	-	6,347	-	6,347
Endowment Net Assets, December 31, 2016	$ -	$ 104,972	$ 284,354	$ 389,326

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the Act requires the Corporation to retain as a fund of perpetual duration. As of December 31, 2016 and 2015, there were no deficiencies of this nature that are reported in unrestricted net assets.

Other Policies

The Corporation has established guidelines for accepting, investing, managing and using endowments, both restricted and endowments created by donors or unrestricted quasi-endowments created by the Board of Directors. Once the requirements are met to establish an endowment, a portion of the endowment principal is deemed expendable for spending. Up to 5% of the three-year rolling average market value for the three years prior to the year prior to the budgetary year shall be deemed expendable. Any funds not expended in that year, may be carried over for future use or returned to principal.

NOTE 6 CONSTRUCTION IN PROGRESS

Kendal at Lexington is in the process of renovating both the Webster Assisted Living Center and the Benjamin Borden Health Center and expanding the number of residential living units. As of December 31, 2016, $1,101,728 has been incurred for the master plan, pre-construction costs, schematic design and design development.

The Corporation is in the process of a land exchange of approximately 12 acres of bordering buildable farmland. Kendal will receive $24,000 in addition to the land from the exchange. Included in Construction in Progress is $13,167 of costs incurred through December 31, 2016. The exchange is expected to be finalized in the second quarter of 2017.

NOTE 7 LONG-TERM DEBT

In June 2007, the Industrial Development Authority of the City of Lexington, Virginia, issued $34,155,000 of Tax-Exempt and $645,000 of Taxable Residential Care Facilities Mortgage Revenue Bonds (the “Series 2007 Bonds”). The proceeds of the Series 2007 Bonds were used to repay the Series 2001 bonds and the Stonewall Jackson Hospital note, and to defease the Series 1999 Bonds. In addition, $25 million from the sale of the bonds was used to provide for construction of 32 cottages, a 14-apartment addition, a fitness center and renovations to the commons building.

Bond proceeds also paid a portion of the interest on the bonds during construction, funded the cost of issuance associated with the transaction including feasibility, legal and underwriting expenses, and establish a debt service reserve fund. The bonds were issued at a discount of $328,530.

Principal on the Series 2007 Bonds is due annually on January 1 of each year beginning January 1, 2008 for the tax-exempt bonds, and beginning January 1, 2010 for the taxable bonds. Interest is due semi-annually on January 1 and July 1 for the tax-exempt and taxable bonds. The interest on these bonds is paid semi-annually.

In October 2016, the Industrial Development Authority of the City of Lexington, Virginia, issued $28,210,000 of Tax-Exempt Residential Care Facility Refund Revenue Bonds. Principal is due annually on January 1 of each year. Interest is due semiannually on January 1 and July I beginning January 1, 2017. There was no interest paid on the Series 2016 bonds in 2016.

The proceeds of the Series 2016 Bonds were used to refund the Authority's Residential Care Facilities Mortgage Revenue Bonds Series 2007A, to fund a debt service reserve fund for the Series 2016 Bonds, and to finance cost of issuing the Series 2016 Bonds. At the time of issuance, a portion of the proceeds were placed into escrow to refund the Series 2007A Bonds on January 1, 2017. As of December 31, 2016, the Series 2007A bonds were no longer outstanding and deemed to be fully defeased. The bonds were issued at a premium of $1,765,790.

During 2016, the Corporation recorded a loss on defeasance totaling $979,159, including $552,067 related to the write-off of deferred financing costs.

NOTE 7 LONG-TERM DEBT (CONTINUED)

The components and maturities of long-term debt are as follows:

	2016	2015
Series 2016:		
Tax-Exempt Serial Bonds, Maturing between 2017 and 2024 at Rates Varying from 1.00% to 4.00% and Amounts Ranging from $20,000 to $1,215,000	$ 7,690,000	$ -
Tax-exempt Term Bond, 2.75%, Maturing 2026	2,565,000	-
Tax-exempt Term Bond, 4.00%, Maturing 2031	6,480,000	-
Tax-exempt Term Bond, 3.25%, Maturing 2031	760,000	-
Tax-exempt Term Bond, 4.00%, Maturing 2037	8,815,000	-
Tax-exempt Term Bond, 3.375%, Maturing 2037	1,900,000	-
Series 2007:		
Tax-Exempt Serial Bonds, Maturing between 2016 and 2023 at Rates Varying from 5.175% to 5.375% and Amounts Ranging from $710,000 to $1,015,000	-	6,830,000
Tax-Exempt Term Bonds, 5.375%, Maturing between 2024 and 2028, Amounts Ranging from $1,070,000 to $1,320,000	-	5,965,000
Tax-Exempt Term Bonds, 5.5%, Maturing between 2029 and 2037, Amounts Ranging from $1,390,000 to $4,520,000	-	18,050,000
Long-Term Debt	28,210,000	30,845,000
Unamortized Debt Issuance Costs	(581,798)	(590,587)
Unamortized Bond Premium	1,765,790	-
Unamortized Bond Discount	-	(194,298)
Total	29,393,992	30,060,115
Less: Current Portion of Long-Term Debt	(20,000)	(710,000)
Long-term Debt, Net of Current Portion	$ 29,373,992	$ 29,350,115

NOTE 7 LONG-TERM DEBT (CONTINUED)

As of December 31, 2016, aggregate principal maturities for long-term debt and bond premium amortization over the next five years and thereafter are as follows:

Year Ending December 31,	Amount	Bond Premium
2017	$ 20,000	$ 171,799
2018	1,010,000	171,799
2019	1,020,000	171,799
2020	1,050,000	159,090
2021	1,080,000	146,012
Thereafter	24,030,000	945,291
Total	$ 28,210,000	$ 1,765,790

Interest expense paid totaled approximately $2,206,992 and $1,707,292 for the years ended December 31, 2016 and 2015, respectively.

The Corporation has pledged certain assets, including, but not limited to gross receipts, which include all revenues, investments, accounts, inventory and entry fees, to the extent they are not held in escrow under Virginia requirements; as well as the rights under the residency agreements. Donor-restricted gifts cannot be used as collateral. There is a lien on, as well as a security interest in, all fixtures, furniture and equipment.

Among other things, the Corporation is required to meet certain marketing and financial covenants under the security agreements related to the bond issue. There are financial and operational covenants associated with the bond. As of December 31, 2016, management is not aware of any instances of non-compliance with the required covenants.

NOTE 8 RETIREMENT PLANS

The Corporation participates in The Kendal Corporation Pension Plan, a noncontributory defined benefit plan along with other entities affiliated with The Kendal Corporation. An employee is eligible for the plan when the employee has worked 1,000 hours per year, attained the age of 21, and has completed one year of eligible service. In order to be vested, an employee needs five years of vesting service. A year of vesting service is earned when an employee works at least 1,000 hours. Total expenses related to the Plan during fiscal 2016 and 2015 were $66,420 and $40,848, respectively. On January 1, 2015, the Plan was frozen.

Effective July 1, 2006, the Corporation participates in a defined contribution plan under Internal Revenue Code Section 401(a) and 403(b) through The Kendal Corporation. The plan contains an employer grant and/or match component for eligible employees. Eligible employees must have attained age 21 and must complete one eligibility year of service. The Corporation’s grant and/or matching contribution is discretionary. All employees are eligible to make contributions to the plan. The Corporation may elect a basic contribution percentage of annual compensation or a grant subject to certain limitations. Contributions accrued by the Corporation were approximately $219,764 and $177,636 for the years ended December 31, 2016 and 2015, respectively.

NOTE 9 CONCENTRATION OF CREDIT RISK

The Corporation grants credit without collateral to their residents, most of whom are insured under third-party payor agreements. The mix of the Corporation's net receivables from residents and third-party payors as of December 31 was as follows:

	2016	2015
Medicare	36%	29%
Medicaid	26%	21%
Residents and Other	38%	50%
Total	100%	100%

NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurement applies to reported balances that are required or permitted to be measured at fair value under an existing accounting standard. The Corporation emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability and establishes a fair value hierarchy. The fair value hierarchy consists of three levels of inputs that may be used to measure fair value as follows:

Level 1 – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access.

Level 2 – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following table presents the fair value hierarchy for the balances of the assets of the Corporation measured at fair value on a recurring basis as of December 31:

	Level 1	Level 2	Level 3	Total
December 31, 2016:				
Investments:				
Mutual Funds	$ 12,422,001	$ -	$ -	$ 12,422,001
Equities	501	-	-	501
Total	$ 12,422,502	$ -	$ -	$ 12,422,502
Assets Limited as to Use:				
Mutual Funds	$ 2,266,219	$ -	$ -	$ 2,266,219
Beneficial Interest in				
Charitable Remainder Unitrust	$ -	$ -	$ 17,075	$ 17,075

	Level 1	Level 2	Level 3	Total
December 31, 2015:				
Investments:				
Mutual Funds	$ 9,839,135	$ -	$ -	$ 9,839,135
U.S. Government Securities	581,485	-	-	581,485
Corporate Bonds	462,274	-	-	462,274
Equities	496,799	-	-	496,799
Total	$ 11,379,693	$ -	$ -	$ 11,379,693
Assets Limited as to Use:				
Mutual Funds	$ 1,544,156	$ -	$ -	$ 1,544,156
Beneficial Interest in				
Charitable Remainder Unitrust	$ -	$ -	$ 14,616	$ 14,616

Investments and Assets Limited as to Use

Investments and Assets limited as to use are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Securities valued using Level 1 inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Government and Corporate Obligations and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets.

NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Beneficial Interest in Charitable Remainder Unitrust

Fair values of the beneficial interest in a charitable remainder unitrust are determined based upon good faith estimates of the trust's assets less the present value of estimated future payments to the recipient. The present value is based upon an estimated discount rate and applicable mortality tables and, accordingly, is classified as using a Level 3 input.

NOTE 11 FUNCTIONAL EXPENSES

The Corporation provides residential and health care services to residents. The functional allocation of these expenses related to these services is as follows:

	2016	2015
Residential and Health Care Services	$ 10,461,975	$ 10,044,152
General and Administrative	4,354,337	4,366,361
Fundraising	6,571	2,614
Total	$ 14,822,883	$ 14,413,127

NOTE 12 COMMITMENTS AND CONTINGENCIES

Compliance

The Corporation operates in the health care industry and may be subject to legal proceedings and claims from time to time that arise in the course of providing its services. The Corporation maintains malpractice insurance coverage on an occurrence basis, which provides coverage for claims occurring during the policy year. Management has determined that no provision is required for amounts expected to be paid under the policy's deductible limits for unasserted claims not covered by the policy and any other uninsured liability.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse.

Development Agreement

On November 16, 2016, the Corporation entered into a development agreement with Kendal Corporation for the management, in collaboration with the Executive Director, of the expansion and re-positioning of its campus, including renovations and additions to the health centers, additional residential living cottages, new and expanded dining venues and kitchen renovations, an emergency access road, and a maintenance building. The fee related to this agreement is a minimum of $875,000 up to a maximum of $1,050,000, which will be paid over the construction period of the project.

NOTE 12 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Other

In the normal course of business, there could be various outstanding claims and contingent liabilities. No contingent liabilities are reflected in the accompanying financial statements. No such liabilities have been asserted and, therefore, no estimate of loss, if any, is determinable.

NOTE 13 INSURANCE

In 2014, the Corporation began participating in an insurance risk retention group, the Peace Church Risk Retention Group (the "PCRRG"), a group insurance captive corporation licensed by the State of Vermont, to cover basic professional and general liability insurance on a claims-made basis. Entrance into the captive required a capital purchase of stock of $50,682. The investment is accounted by the cost method and is included in other assets on the balance sheet.

NOTE 14 SELF-INSURED GROUP HEALTH PLAN

Effective January 1, 2014, Kendal at Lexington elected to participate in a self-insured medical and prescription plan established by The Kendal Corporation for the benefit of the employees of The Kendal Corporation and the employees of participating Kendal Affiliates, the "Welfare Plan". The Kendal Corporation serves as the Welfare Plan sponsor and has established operational guidelines for the Welfare Plan as well as an oversight committee which includes representatives from participating Affiliates. With the assistance of consultants, the committee will estimate future claims as well as required premiums to fund future claims and establish required cash balances. The total premium determined for the Welfare Plan will be allocated using the participating lives for each participating entity. The premiums will be determined based on a shared risk pool and will not be adjusted to reflect the claims experience of any participating entity. There is an initial commitment of five years from the effective date of participation.

The Welfare Plan is administered by an insurance carrier and backed by a letter of credit. The Welfare Plan is responsible for funding employer liability losses to a maximum of $125,000 per participant in 2016 and $100,000 per participant in 2015 and $1,000,000 in the aggregate per policy year. Third party stop-loss insurance coverage is in place for losses that exceed these amounts.

Kendal at Lexington has executed a Joinder Agreement with The Kendal Corporation to participate in the Welfare Plan effective January 1, 2014. In conjunction with execution of this agreement, Kendal at Lexington's ownership interest in the Welfare Plan is $266,960 and $260,758 as of December 31, 2016 and 2015, respectively.

Self-Insurance expense was $762,293 and $677,517 for the years ended December 31, 2016 and 2015, respectively.