



**INDEPENDENT AUDITORS' REPORT
AND
FINANCIAL STATEMENTS**

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015



HANSEN HUNTER & CO. P.C.
Certified Public Accountants

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HANSEN HUNTER & CO. P.C.
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Brethren Hillcrest Homes
La Verne, California

We have audited the accompanying financial statements of Brethren Hillcrest Homes (a California not-for-profit corporation), which comprise the statements of financial position as of June 30, 2016 and 2015, and the related statements of activities 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.

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

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



HANSEN HUNTER & CO. P.C.
Certified Public Accountants

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Brethren Hillcrest Homes, as of June 30, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Hansen Hunter & Co. P.C.

October 12, 2016

BRETHREN HILLCREST HOMES
STATEMENTS OF FINANCIAL POSITION

ASSETS

| | June 30, | |
|------------------------------------|----------------------|----------------------|
| | 2016 | 2015 |
| Current assets | | |
| Cash and cash equivalents | \$ 8,854,112 | \$ 8,124,358 |
| Accounts receivable, net | 1,032,869 | 916,954 |
| Entrance fees receivable | 1,279,534 | 788,101 |
| Interest receivable | 7,474 | 17,388 |
| Inventory | 51,413 | 42,863 |
| Prepaid expenses and deposits | 285,132 | 247,822 |
| Total current assets | 11,510,534 | 10,137,486 |
| Non-current assets | | |
| Assets whose use is limited | 18,091,945 | 16,551,478 |
| Investments | 378,466 | 340,363 |
| Debt issuance costs, net | 425,405 | 446,765 |
| Property, plant and equipment, net | 68,220,233 | 67,857,617 |
| Total assets | \$ 98,626,583 | \$ 95,333,709 |

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

BRETHREN HILLCREST HOMES**STATEMENTS OF FINANCIAL POSITION**

(Continued)

LIABILITIES AND NET ASSETS

| | June 30, | |
|---|----------------------|----------------------|
| | <u>2016</u> | <u>2015</u> |
| Current liabilities | | |
| Accounts payable | \$ 666,138 | \$ 640,616 |
| Accrued expenses | 948,072 | 1,123,180 |
| Refundable deposits | 28,195 | 27,420 |
| Prepaid resident service fees | 914,064 | 190,700 |
| Current portion of long-term debt | 1,150,000 | 1,115,000 |
| Entrance fee refund payable | 74,813 | - |
| Interest payable | 219,896 | 238,800 |
| | <u>4,001,178</u> | <u>3,335,716</u> |
| Total current liabilities | | |
| | <u>4,001,178</u> | <u>3,335,716</u> |
| Non-current liabilities | | |
| Long-term debt | 36,520,782 | 37,723,791 |
| Other long-term liability | 209,896 | 226,042 |
| Annuities payable | 1,144,803 | 1,320,034 |
| Repayable entrance fees | 1,068,684 | 1,221,177 |
| Deferred revenue from advance fees | 28,466,259 | 27,439,475 |
| | <u>71,411,602</u> | <u>71,266,235</u> |
| Total liabilities | | |
| | <u>71,411,602</u> | <u>71,266,235</u> |
| Net assets | | |
| Unrestricted | 17,816,308 | 14,870,511 |
| Temporarily restricted | 2,410,241 | 2,407,148 |
| Permanently restricted | 6,988,432 | 6,789,815 |
| | <u>27,214,981</u> | <u>24,067,474</u> |
| Total net assets | | |
| | <u>27,214,981</u> | <u>24,067,474</u> |
| Total liabilities and net assets | <u>\$ 98,626,583</u> | <u>\$ 95,333,709</u> |

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

BRETHREN HILLCREST HOMES

STATEMENTS OF ACTIVITIES

| | Years Ended June 30, | |
|---------------------------------------|----------------------|-------------------|
| | 2016 | 2015 |
| Revenues | | |
| Residential Living | \$ 11,441,934 | \$ 10,708,678 |
| Birch Court | 1,847,956 | 1,929,361 |
| Woods Assisted Living | 406,217 | 385,960 |
| Southwoods Lodge | 1,480,230 | 1,343,472 |
| Woods Health Services | 5,804,307 | 5,916,087 |
| Telephone system | 142,375 | 144,949 |
| Rentals | 53,528 | 80,068 |
| Other revenue | 1,549,529 | 1,381,188 |
| Donations | 377,738 | 51,284 |
| Investment income, net | 165,739 | 172,297 |
| Net realized gains on investments | 8,720 | 121,982 |
| Net assets released from restrictions | 379,282 | 483,790 |
| Total revenues | 23,657,555 | 22,719,116 |
| Expenses | | |
| Residential Living | 8,000,055 | 7,584,126 |
| Birch Court | 478,054 | 505,294 |
| Woods Assisted Living | 279,173 | 209,093 |
| Southwoods Lodge | 785,612 | 726,716 |
| Woods Health Services | 3,772,258 | 3,568,029 |
| Marketing and development | 1,066,813 | 1,099,044 |
| Management and general | 1,628,823 | 1,689,363 |
| Interest | 1,745,137 | 1,931,886 |
| Depreciation | 3,278,446 | 3,191,670 |
| Amortization | 21,359 | 19,579 |
| Insurance | 404,416 | 367,459 |
| Telephone system | 178,840 | 176,396 |
| Bad debt expense | 35,886 | - |
| Inter-fund interest | 117,623 | 117,623 |
| Total expenses | 21,792,495 | 21,186,278 |

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

BRETHREN HILLCREST HOMES**STATEMENTS OF ACTIVITIES**

(Continued)

| | Years Ended June 30, | |
|--|----------------------|----------------------|
| | <u>2016</u> | <u>2015</u> |
| Change in unrestricted net assets from operations | \$ 1,865,060 | \$ 1,532,838 |
| Unrealized loss on investments | (246,263) | (233,450) |
| Unrealized gain on land investment | 1,327,000 | 1,323,000 |
| Loss on long-term debt refinance | - | (1,678,145) |
| Change in unrestricted net assets | <u>2,945,797</u> | <u>944,243</u> |
| Changes in temporarily restricted net assets: | | |
| Contributions | 336,114 | 377,792 |
| Interest income | 117,623 | 117,623 |
| Present value adjustment of gift annuities payable | (71,362) | (74,946) |
| Net assets released from restriction | <u>(379,282)</u> | <u>(483,790)</u> |
| Change in temporarily restricted net assets | <u>3,093</u> | <u>(63,321)</u> |
| Changes in permanently restricted net assets: | | |
| Contributions | 269,975 | 5,597 |
| Investment income | 4 | 195 |
| Present value adjustment of gift annuities payable | <u>(71,362)</u> | <u>(74,946)</u> |
| Change in permanently restricted net assets | <u>198,617</u> | <u>(69,154)</u> |
| Change in total net assets | <u>3,147,507</u> | <u>811,768</u> |
| Net assets, beginning of year | <u>24,067,474</u> | <u>23,255,706</u> |
| Net assets, end of year | <u>\$ 27,214,981</u> | <u>\$ 24,067,474</u> |

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

BRETHREN HILLCREST HOMES**STATEMENTS OF CASH FLOWS**

| | Years Ended June 30, | |
|---|----------------------|---------------------|
| | 2016 | 2015 |
| Cash flows from operating activities | | |
| Cash received from residents | \$ 18,373,194 | \$ 17,109,225 |
| Non-refundable entrance fees received | 5,594,923 | 7,637,992 |
| Contributions | 112,435 | 46,736 |
| Investment income received | 184,377 | 281,540 |
| Interest expense paid | (1,817,050) | (2,651,371) |
| Cash paid to suppliers and employees | <u>(16,882,221)</u> | <u>(15,751,715)</u> |
| Net cash provided by operating activities | <u>5,565,658</u> | <u>6,672,407</u> |
| Cash flows from investing activities | | |
| Capital expenditures | (3,436,717) | (3,018,045) |
| Change in assets whose use is limited | (493,514) | 18,291 |
| Change in investments | <u>(4,319)</u> | <u>(4,327)</u> |
| Net cash used in investing activities | <u>(3,934,550)</u> | <u>(3,004,081)</u> |
| Cash flows from financing activities | | |
| Proceeds from contributions restricted for: | | |
| Investment in endowment | 269,975 | 5,597 |
| Investment in temporarily restricted assets | 336,114 | 491,516 |
| Investment subject to annuity agreements | 29,682 | 28,973 |
| Other financing activities: | | |
| Debt issuance fees paid | - | (415,000) |
| Entrance fees repaid | (228,953) | (765,512) |
| Debt principal payments | (1,115,000) | (930,000) |
| Proceeds from Series 2014 Certificates | - | 39,817,382 |
| Payoff of Series 2003 Certificates | - | (40,285,000) |
| Prepayment penalty | - | (201,425) |
| Payments on annuity obligations | <u>(193,172)</u> | <u>(208,011)</u> |
| Net cash used in financing activities | <u>(901,354)</u> | <u>(2,461,480)</u> |
| Net change in cash and cash equivalents | 729,754 | 1,206,846 |
| Cash and cash equivalents, beginning of year | <u>8,124,358</u> | <u>6,917,512</u> |
| Cash and cash equivalents, end of year | <u>\$ 8,854,112</u> | <u>\$ 8,124,358</u> |

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

BRETHREN HILLCREST HOMES

STATEMENTS OF CASH FLOWS

(Continued)

| | Years Ended June 30, | |
|---|----------------------|---------------------|
| | 2016 | 2015 |
| Change in net assets | \$ 3,147,507 | \$ 811,768 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Amortization of entrance fees | (4,908,299) | (4,420,984) |
| Amortization of gift annuities | 142,724 | 149,892 |
| Depreciation | 3,278,446 | 3,191,670 |
| Amortization of debt issuance costs | 21,359 | 19,579 |
| Amortization of other long-term liability | (16,146) | (16,146) |
| Amortization of long-term debt premium | (53,009) | (48,591) |
| Restricted contributions | (606,089) | (383,389) |
| Net unrealized gain on investments | (1,080,737) | (1,089,550) |
| Loss on asset disposal | - | 41,226 |
| Other change in annuities payable | (154,465) | (4,548) |
| Non-refundable entrance fees received | 5,594,923 | 7,637,992 |
| Prepayment penalty | - | 201,425 |
| Loss on write off of debt issuance costs | - | 1,497,170 |
| Donated assets | (110,838) | - |
| | | |
| (Increase) decrease in operating assets: | | |
| Accounts receivable | (115,915) | (383,108) |
| Interest receivable | 9,914 | (12,934) |
| Inventory | (8,550) | (1,403) |
| Prepaid expenses and deposits | (37,310) | (43,652) |
| | | |
| Increase (decrease) in operating liabilities: | | |
| Accounts payable | (67,984) | 127,388 |
| Accrued expenses | (175,108) | 16,177 |
| Refundable deposits | 775 | 1,950 |
| Prepaid residential fees | 723,364 | 39,700 |
| Interest payable | (18,904) | (659,225) |
| | | |
| Net cash provided by operating activities | \$ 5,565,658 | \$ 6,672,407 |

Supplemental disclosures of cash flow information:

| | | |
|--|------------|------|
| Noncash investing and financing activities: | | |
| Donated assets | \$ 110,838 | \$ - |
| Fixed asset additions included in accounts payable | \$ 93,507 | \$ - |

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

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – NATURE OF BUSINESS:

Brethren Hillcrest Homes (Hillcrest) was incorporated in 1947 as a California tax-exempt not-for-profit corporation, as described in Section 501(c)(3) of the Internal Revenue Code, to operate a continuing care retirement community. Accordingly, contributions to Hillcrest qualify as deductible charitable contributions for income tax purposes. Residents of the retirement community receive housing and related services, including health care, based on individual contracts which may include an entrance fee, monthly fee or a daily fee for services provided. The facility, which is located in La Verne, California, services approximately 400 residents.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation - The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the 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 - Hillcrest considers all highly liquid instruments, those with a maturity of three months or less at the time of purchase, to be cash equivalents, excluding assets whose use is limited. The carrying amount reported in the statements of financial position for cash and cash equivalents approximates fair value due to the short-term nature of these financial instruments.

Accounts Receivable - Bad debts are accounted for by the allowance method. Hillcrest estimates the allowance based upon its experience. The allowance for doubtful accounts was \$83,530 and \$62,739 at June 30, 2016 and 2015, respectively. Accounts receivable over 90 days old were \$392,178 and \$212,425 at June 30, 2016 and 2015, respectively.

Inventory Valuation - Inventory, which primarily consists of dietary, housekeeping and office supplies, is recorded at cost based on the first-in/first-out method.

Debt Issuance Costs - Costs related to the issuance of the Certificates of Participation are amortized over the term of the debt.

Assets Whose Use is Limited - Assets whose use is limited consist of cash, money market funds, land and other investments. These assets are limited as to their use by the board of directors, donor designations, or the Certificates of Participation purchase agreement. These assets are reported at fair market value.

Investments - Hillcrest considers its investments in marketable securities as available for sale, as they are not intended to be held to maturity, nor are they considered operating assets, and as such are carried at fair value. Donated investments are reported at fair value at the date of gift.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Investments (continued) - Realized gains and losses on dispositions are based on the sale proceeds versus the cost basis of the securities sold. Unrealized gains and losses represent the net change in fair value of the securities and are recorded as an increase or decrease to net assets.

Investment income is recorded net of related fees of \$49,581 and \$42,608 for the years ended June 30, 2016 and 2015, respectively.

Amortization of Entrance Fees - Lump sum entrance fees are amortized to determine the amount of fees to be included in revenues, in the manner prescribed by the Revenue Recognition Topic of the FASB Accounting Standards Codification. The amount to be included is calculated by dividing the unamortized entrance fee by the current life expectancy of each resident and summing the results for all residents. The Life Expectancy Tables as published in Section 1792.6 of the State of California Continuing Care Contract Statutes are used in making the above computations. The unamortized portion is shown on the balance sheet as deferred revenue. Current year activity of the unamortized portion of entrance fees is summarized as follows:

| | <u>Years Ended June 30,</u> | |
|---|-----------------------------|----------------------|
| | <u>2016</u> | <u>2015</u> |
| Balance, beginning of year | \$ 27,439,475 | \$ 24,792,848 |
| Sale of contracts | 6,086,358 | 7,314,070 |
| Refunds | (151,275) | (246,459) |
| Amortization of continuing care contracts | <u>(4,908,299)</u> | <u>(4,420,984)</u> |
| Balance, end of year | \$ <u>28,466,259</u> | \$ <u>27,439,475</u> |

Non-Refundable Fees - Hillcrest is obligated to refund a portion of entrance fees to residents who withdraw before fifty months. If the resident withdraws within three months, the entire entrance fee is refunded. Contracts are refundable over fifty months, with the refundable amount reduced by 2.00% per month, less a 4% termination fee.

Repayable Contracts - Hillcrest has five contracts under a repayable entrance fee program that are entitled to a refund of 50% or 90% of the total entrance fee, less a 4% termination fee, upon withdrawal or death after the unit is reoccupied.

The total liability for the repayable entrance fee contracts was \$1,068,684 and \$1,221,177 at June 30, 2016 and 2015, respectively.

Net Asset Classes - Hillcrest classifies its net assets into three categories: unrestricted, temporarily restricted and permanently restricted.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Net Asset Classes (continued) - Unrestricted net assets generally result from revenues from providing services, receiving unrestricted contributions and receiving dividend and interest income, less expenses incurred in providing services, raising contributions, and performing administrative functions. The only limits on the use of unrestricted net assets are the broad limits resulting from Hillcrest's mission as defined in its articles of incorporation and bylaws.

Temporarily restricted net assets are limited by donors for specific purposes or the lapse of specified time periods.

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

Board Designated Amounts - Directors have designated certain unrestricted amounts for specific purposes. Amounts designated for operations and capital purposes were \$1,654,404 and \$1,680,388 at June 30, 2016 and 2015, respectively. Amounts designated for benevolent purposes were \$3,960,013 and \$4,056,229 at June 30, 2016 and 2015, respectively. Amounts designated for repayment of restricted net asset loans were \$1,262,943 and \$889,915 at June 30, 2016 and 2015, respectively. Inasmuch as these amounts have no donor restrictions, the Board may rescind the designation of these amounts at any time.

Net Patient Service Revenue - Hillcrest has agreements with third-party payors that provide for payments to Hillcrest at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Net resident revenues from Medicare were \$221,718 and \$219,221 for the years ended June 30, 2016 and 2015, respectively. Net resident revenues from Medi-Cal were \$1,743,323 and \$1,867,648 for the years ended June 30, 2016 and 2015, respectively. Upon audit by the State or Medicare, there is a possibility of adjustment to costs reimbursed.

Donor-Restricted Gifts - Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donated property and equipment are reported as unrestricted support, unless subject to time restrictions by donors.

Donated Services - Significant amounts of time from a number of people have been donated to Hillcrest. The accompanying financial statements do not reflect the value of those donated services as no reliable basis exists for reasonably determining the amounts involved.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Obligation to Provide Future Services - Annually, Hillcrest 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 balance of deferred revenue from entrance fees. If the present value of the net cost of future services and use of facilities exceeds the deferred revenue from entrance fees, a liability is recorded (obligation to provide future services and use of facilities) with the corresponding charge to expense. For the years ended June 30, 2016 and 2015, the calculation resulted in no future service liability. The discount rate used was 6%.

Gift Annuities - Hillcrest sponsors a charitable gift annuity program as part of its fund raising activities. All amounts received in exchange for these annuity contracts are segregated for accounting and investment purposes. Management has interpreted the agreements to require investment of the entire contract amount until the annuitant dies. At the time of death of the annuitant, the residuum is distributed to the designated net asset class as specified by the annuitant at the time the agreement was issued. If no designation was made, the residuum is distributed to the unrestricted net asset class.

Gift annuity contracts are a general liability of Hillcrest and are not limited to the segregated assets. The actuarially determined liability is calculated annually and adjusted accordingly. The discount rate and actuarial assumptions used in calculating the annuity obligation are those provided in Internal Revenue Service guidelines and actuarial tables. As a qualifying not-for-profit corporation, Hillcrest is authorized by the State of California to issue gift annuity contracts and is accordingly subject to applicable State laws and regulations.

Financial Instruments - Hillcrest's financial instruments consist of accounts receivable, entrance fees receivable, interest receivable, deposits, assets whose use is limited, investments, accounts payable, accrued expenses, refundable deposits, entrance fee refund payable, interest payable, long-term debt, annuities payable and repayable entrance fees. It is management's opinion that Hillcrest is not exposed to significant interest rate or credit risk arising from these instruments. Unless otherwise noted, the fair value of these financial instruments approximates their carrying values.

Concentrations of Credit Risk - Hillcrest is a continuing care retirement community whose only campus is located in La Verne, California. For monthly fees charged to residents, Hillcrest grants credit on an unsecured basis.

Hillcrest has reserve funds, comprised of cash and equivalents and investments, located in various institutions. At times, the amount on deposit in some of the institutions exceeds the federally-insured limit.

Advertising - Advertising and marketing costs are charged to expense at the time they are incurred. Total advertising expense was \$179,410 and \$226,997 for the years ended June 30, 2016 and 2015, respectively.

Functional Expenses - The expenses of Hillcrest are presented according to their functional classification in the accompanying Statements of Activities. Fundraising expense was \$278,211 and \$261,013 for the years ended June 30, 2016 and 2015, respectively.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Income Taxes – Hillcrest is tax-exempt organizations pursuant to Internal Revenue Code (IRC) Section 501(c)(3) and applicable state law; therefore, no provision for income taxes has been made in the accompanying financial statements.

NOTE 3 – ASSETS WHOSE USE IS LIMITED:

Assets whose use is limited are recorded at fair market value and consist of the following as of:

| | June 30, | |
|---|---------------|---------------|
| | 2016 | 2015 |
| <i><u>Funds Held by Trustee</u></i> | | |
| Certificates of Participation Reserve fund | \$ 2,934,100 | \$ 2,934,100 |
| Certificates of Participation Revenue/Sinking funds | 290,072 | 288,138 |
| | 3,224,172 | 3,222,238 |
| <i><u>Board Designated Funds</u></i> | | |
| Benevolence | 3,960,013 | 4,056,229 |
| Operating and capital reserve | 1,654,404 | 1,680,388 |
| Restoration fund | 1,262,943 | 889,915 |
| | 6,877,360 | 6,626,532 |
| <i><u>Endowment Funds</u></i> | | |
| Endowment funds | 3,691,431 | 2,726,637 |
| <i><u>Gift Annuities</u></i> | | |
| Gift annuities funds | 1,890,786 | 2,031,926 |
| <i><u>Specific Purpose</u></i> | | |
| Specific purposes funds | 2,377,387 | 1,913,336 |
| <i><u>Resident Association</u></i> | | |
| Resident association funds | 30,809 | 30,809 |
| | \$ 18,091,945 | \$ 16,551,478 |

The Board Designated Funds listed above are fully funded and will be used to help residents at Brethren Hillcrest Homes who need assistance to afford their monthly fees if approved by the Benevolence Committee.

There were no expenditures made from the Board Designated Benevolence funds during the year ended June 30, 2016.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 3 – ASSETS WHOSE USE IS LIMITED (continued):

The assets are invested as follows:

| | June 30, | |
|--------------------------------------|---------------|---------------|
| | 2016 | 2015 |
| <i><u>Funds Held by Trustee</u></i> | | |
| Cash and money markets | \$ 3,224,172 | \$ 3,222,238 |
| <i><u>Board Designated Funds</u></i> | | |
| Cash and money markets | 334,105 | 577,780 |
| Fixed income securities | 1,417,087 | 1,351,612 |
| Equity securities | 5,126,168 | 4,697,140 |
| | 6,877,360 | 6,626,532 |
| <i><u>Endowment Funds</u></i> | | |
| Cash and money markets | 184,089 | 68,575 |
| Land | 3,507,342 | 2,658,062 |
| | 3,691,431 | 2,726,637 |
| <i><u>Gift Annuities</u></i> | | |
| Cash and money markets | 13,046 | 14,910 |
| Fixed income securities | 1,053,027 | 1,044,011 |
| Equity securities | 824,713 | 973,005 |
| | 1,890,786 | 2,031,926 |
| <i><u>Specific Purpose</u></i> | | |
| Cash and money markets | 384,729 | 398,398 |
| Land | 1,992,658 | 1,514,938 |
| | 2,377,387 | 1,913,336 |
| <i><u>Resident Association</u></i> | | |
| Cash and money markets | 30,809 | 30,809 |
| | \$ 18,091,945 | \$ 16,551,478 |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 4 – DEBT ISSUANCE COSTS:

Debt issuance costs consist of the following as of:

| | June 30, | |
|--------------------------|------------|------------|
| | 2016 | 2015 |
| Debt issuance costs | \$ 466,344 | \$ 466,344 |
| Accumulated amortization | (40,939) | (19,579) |
| | \$ 425,405 | \$ 446,765 |

During the year ended June 30, 2015, Hillcrest refinanced its long-term debt. Unamortized costs associated with the issuance of the 2003 Certificates, in the amount of \$1,497,170, were written off. This is included in loss on long-term debt refinance on the statements of activities for the year ended June 30, 2015. Costs related to the refinance in the amount of \$415,000 and \$51,344 were incurred during the years ended June 30, 2015 and 2014, respectively. Future amortization of these costs is as follows:

| Years Ended June 30, | Amount |
|----------------------|------------|
| 2017 | \$ 21,359 |
| 2018 | 21,359 |
| 2019 | 21,359 |
| 2020 | 21,359 |
| 2021 | 21,359 |
| Thereafter | 318,610 |
| Total | \$ 425,405 |

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT:

Acquisitions greater than \$500 and with an expected life of one year or more are capitalized at cost. When property is donated, it is capitalized at fair value at the date of the gift. Interest paid during the construction period of an asset is capitalized.

Depreciation is computed on the straight-line basis over estimated useful lives as follows:

| | |
|----------------------------|----------------------------|
| Buildings and improvements | Principally 25 to 40 years |
| Equipment and vehicles | Principally 3 to 20 years |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT (continued):

Property, plant and equipment are summarized as follows as of:

| | June 30, | |
|---|----------------------|----------------------|
| | <u>2016</u> | <u>2015</u> |
| Land | \$ 1,883,973 | \$ 1,883,973 |
| Land improvements | 813,758 | 717,758 |
| Master plan | 11,703 | 11,703 |
| Buildings and improvements | 99,101,182 | 97,024,423 |
| Furniture, fixtures, equipment and vehicles | 4,688,421 | 4,523,598 |
| | <u>106,499,037</u> | <u>104,161,455</u> |
| Less: accumulated depreciation | <u>(40,766,035)</u> | <u>(37,703,521)</u> |
| Subtotal | 65,733,002 | 66,457,934 |
| Construction-in-progress | <u>2,487,231</u> | <u>1,399,683</u> |
| Total | \$ <u>68,220,233</u> | \$ <u>67,857,617</u> |

NOTE 6 – FAIR VALUE OF FINANCIAL INSTRUMENTS:

Hillcrest has adopted the requirements of the Fair Value Measurements and Disclosure Topic of the FASB Accounting Standards Codification. This Topic defines fair value and requires enhanced disclosure about assets and liabilities carried at fair value. These additional disclosures are required only for financial assets and liabilities measured at fair value and for nonfinancial assets and liabilities measured at fair value on a recurring basis.

This Topic requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best available information. These assumptions include risks inherent in a particular valuation technique (such as a pricing model) and the risks inherent in the inputs to the model. It also specifies that transaction costs should not be considered in the determination of fair value. According to this Topic, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

This Topic establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by this Topic are as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are observable, either directly or indirectly, but are not quoted prices included within Level 1. Level 2 includes those financial instruments that are valued using external inputs with models or other valuation methodologies.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 6 – FAIR VALUE OF FINANCIAL INSTRUMENTS (continued):

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers’ needs.

As required by this Topic, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The fair value of financial assets and liabilities measured on a recurring basis as of June 30 are as follows:

| | Fair Value Measurements at Reporting Date Using: | | | |
|-----------------------------------|---|---|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | <u>Fair Value</u> | <u>(Level 1)</u> | <u>(Level 2)</u> | <u>(Level 3)</u> |
| <u>June 30, 2016</u> | | | | |
| <u>Assets:</u> | | | | |
| Investments | | | | |
| Insurance investments | \$ 378,466 | \$ - | \$ - | \$ 378,466 |
| Total investments | <u>378,466</u> | <u>-</u> | <u>-</u> | <u>378,466</u> |
| Assets whose use is limited | | | | |
| Cash and money markets | 4,170,950 | 4,170,950 | - | - |
| Large cap equities | 2,493,458 | 2,493,458 | - | - |
| Mid cap equities | 216,139 | 216,139 | - | - |
| Small cap equities | 159,058 | 159,058 | - | - |
| International equities | 1,987,367 | 1,987,367 | - | - |
| Fixed income – | | | | |
| corporate/government | 2,470,114 | 2,470,114 | - | - |
| Real estate funds | 268,388 | 268,388 | - | - |
| Hedge funds | 679,965 | 679,965 | - | - |
| Commodities | 146,506 | 146,506 | - | - |
| Land investment | <u>5,500,000</u> | <u>-</u> | <u>5,500,000</u> | <u>-</u> |
| Total assets whose use is limited | <u>18,091,945</u> | <u>12,591,945</u> | <u>5,500,000</u> | <u>-</u> |
| Total assets | \$ <u>18,470,411</u> | \$ <u>12,591,945</u> | \$ <u>5,500,000</u> | \$ <u>378,466</u> |
| <u>Liabilities:</u> | | | | |
| Annuity payment liability | \$ <u>1,144,803</u> | \$ <u>-</u> | \$ <u>-</u> | \$ <u>1,144,803</u> |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 6 – FAIR VALUE OF FINANCIAL INSTRUMENTS (continued):

| | Fair Value Measurements at Reporting Date Using: | | | |
|--|---|---|--|--|
| | <u>Fair Value</u> | <u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u> | <u>Significant Other Observable Inputs (Level 2)</u> | <u>Significant Unobservable Inputs (Level 3)</u> |
| <u>June 30, 2015</u> | | | | |
| <u>Assets:</u> | | | | |
| Investments | | | | |
| Insurance investments | \$ 340,363 | \$ - | \$ - | \$ 340,363 |
| Total investments | <u>340,363</u> | <u>-</u> | <u>-</u> | <u>340,363</u> |
| Assets whose use is limited | | | | |
| Cash and money markets | 4,312,710 | 4,312,710 | - | - |
| Large cap equities | 2,244,607 | 2,244,607 | - | - |
| Mid cap equities | 151,364 | 151,364 | - | - |
| Small cap equities | 115,962 | 115,962 | - | - |
| International equities | 2,065,551 | 2,065,551 | - | - |
| Other equities | 62,335 | 62,335 | - | - |
| Fixed income – corporate/government | 2,395,623 | 2,395,623 | - | - |
| Real estate funds | 174,716 | 174,716 | - | - |
| Hedge funds | 708,000 | 708,000 | - | - |
| Commodities | 147,610 | 147,610 | - | - |
| Land investment | <u>4,173,000</u> | <u>-</u> | <u>4,173,000</u> | <u>-</u> |
| Total assets whose use is limited | <u>16,551,478</u> | <u>12,378,478</u> | <u>4,173,000</u> | <u>-</u> |
| Total assets | \$ <u>16,891,841</u> | \$ <u>12,378,478</u> | \$ <u>4,173,000</u> | \$ <u>340,363</u> |
| <u>Liabilities:</u> | | | | |
| Annuity payment liability | \$ <u>1,320,034</u> | \$ <u>-</u> | \$ <u>-</u> | \$ <u>1,320,034</u> |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 6 – FAIR VALUE OF FINANCIAL INSTRUMENTS (continued):

Assets measured at fair value on a recurring basis using significant unobservable inputs, Level 3 measurements, consist of the following:

| | <u>Investments</u> |
|---------------------------------|--------------------|
| Balance at June 30, 2014 | \$ 293,274 |
| Unrealized gains on investments | <u>47,089</u> |
| Balance at June 30, 2015 | 340,363 |
| Unrealized gains on investments | <u>38,103</u> |
| Balance at June 30, 2016 | <u>\$ 378,466</u> |

Liabilities measured at fair value on a recurring basis using significant unobservable inputs, Level 3 measurements, consist of the following:

| | <u>Annuity payment liability</u> |
|--|--------------------------------------|
| Balance at June 30, 2014 | \$ 1,353,728 |
| New annuities | 28,973 |
| Payments made to annuitants | (208,011) |
| Revenue on expired contracts | (4,548) |
| Net change in present value of annuities | <u>149,892</u> |
| Balance at June 30, 2015 | 1,320,034 |
| New annuities | 29,682 |
| Payments made to annuitants | (193,172) |
| Revenue on expired contracts | (154,465) |
| Net change in present value of annuities | <u>142,724</u> |
| Balance at June 30, 2016 | <u>\$ 1,144,803</u> |

Financial assets valued using Level 1 inputs are based on unadjusted quoted market prices within active markets. Assets valued using Level 2 inputs are based on appraisals. Fair value for Level 3 assets is determined by the estimated equity value at year end. The fair value for Level 3 liabilities is determined by calculating the present value of cash flows expected to be paid out, using various discount rates and life expectancy tables.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 7 – LONG-TERM DEBT:

Long-term debt consisted of the following as of:

| | June 30, | |
|---|---------------|---------------|
| | 2016 | 2015 |
| City of La Verne Certificates of Participation (Series 2014) | \$ 36,615,000 | \$ 37,730,000 |
| Plus: unamortized premium | 1,055,782 | 1,108,791 |
| Less: current portion of long-term debt | (1,150,000) | (1,115,000) |
| | \$ 36,520,782 | \$ 37,723,791 |

On January 1, 2003, Hillcrest issued \$47,000,000 Revenue Certificates of Participation (2003 Certificates). The 2003 Certificates were payable beginning February 15, 2007, with annual payments scheduled through February 15, 2033. Interest was payable semi-annually on August 15 and February 15, at interest rates ranging from 3.125% to 6.625%.

On July 10, 2014, Hillcrest refinanced the 2003 Certificates with new Certificates of Participation (the Certificates) in the amount of \$38,660,000. The Certificates were payable beginning May 15, 2015, with annual payments scheduled through May 15, 2036. Principal payments range from \$930,000 to \$2,790,000. Interest is payable beginning November 15, 2014, and semi-annually thereafter on May 15 and November 15, at interest rates ranging from 2% to 5%. The Certificates are secured by a pledge of Hillcrest’s gross revenues, and further secured by a first deed of trust on Hillcrest’s real property, rents and leases, personal property and fixtures.

The following table sets forth the principal amounts required to be made available at the principal payment date, or by mandatory prepayment, with respect to the Certificates:

| Years Ended | Interest Rates | Principal |
|-------------|----------------|---------------|
| June 30: | | |
| 2017 | 3% | \$ 1,150,000 |
| 2018 | 4% | 1,185,000 |
| 2019 | 4% | 1,230,000 |
| 2020 | 5% | 1,280,000 |
| 2021 | 5% | 1,345,000 |
| Thereafter | 5% | 30,425,000 |
| | | \$ 36,615,000 |

Hillcrest has secured an investment grade rating from Fitch Ratings, Inc. of “BBB-” for the Certificates. The sale agreement requires Hillcrest to comply with various covenants, conditions and restrictions. A Debt Service Coverage Ratio of 1.20 is required at the end of each fiscal year. A Days Cash On Hand covenant requires 150 days of Cash on Hand each June 30 and December 31. Both of these covenants have been met as of June 30, 2016.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 8 – OTHER LONG-TERM LIABILITY:

On June 8, 1998, Hillcrest entered into an agreement with the City of La Verne involving the cost of certain roadway improvements made to “B” Street, which runs along the eastern side of Hillcrest. The City of La Verne contributed \$82,117 of improvement costs to Hillcrest. Rather than requiring Hillcrest to pay cash to the City, the parties agreed that Hillcrest would set aside six residential units for “very low-income housing” for a term of 15 years per unit or a combination of very low-income housing and three lower-income housing units for every two very low-income housing units not occupied. Hillcrest has recorded the cost in fixed assets, and established a corresponding liability which is amortized over the 15 year term.

During the year ended June 30, 2008, Hillcrest and the City of La Verne agreed to extend this agreement. The City contributed an additional \$296,000 for improvements to Benton Street, and Hillcrest has set aside the agreed-upon units for an additional 15 years beyond the original agreement.

NOTE 9 – TEMPORARILY RESTRICTED NET ASSETS:

Temporarily restricted net assets are available for the following purposes:

| | June 30, | |
|--|--------------|--------------|
| | 2016 | 2015 |
| Fine Arts, Video, Naming | \$ 41,444 | \$ 50,041 |
| Minnie A. Trout Health Services Education | 2,419 | 2,419 |
| C.O.B. Ministers and Missionaries | 117,854 | 117,854 |
| Christian Service | 110,209 | 110,209 |
| Woods discretionary | 5,730 | 5,730 |
| Nurses training – Bowser | 12,939 | 12,939 |
| Entrance fee – Fasnacht | 31,988 | 31,988 |
| Benevolence | 1,893,224 | 2,093,582 |
| Village Tower | 31,132 | 31,132 |
| Dean Kieffaber Chapel | 736 | 7,158 |
| Good Samaritan | 514,504 | 340,344 |
| Woods capital | 109,600 | - |
| Book House | 626 | 50 |
| Chaplain’s foundation – Myrna Wheeler | 1,057 | 814 |
| Channel 3 | 15,564 | 15,564 |
| Cultural arts society | 10,048 | 12,988 |
| Business associates breakfast | 5,892 | 4,892 |
| Village center lift | 1,528 | 1,528 |
| AFC | 6,543 | - |
| Meeting house sound system | 650 | - |
| Annuity contracts available for general purposes | (503,446) | (432,084) |
| | \$ 2,410,241 | \$ 2,407,148 |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 9 – TEMPORARILY RESTRICTED NET ASSETS (continued):

Temporarily restricted net assets were released for the following purposes:

| | June 30, | |
|-------------------------------------|-------------------|-------------------|
| | <u>2016</u> | <u>2015</u> |
| Benevolent purposes | \$ 320,201 | \$ 288,765 |
| Good Samaritan purposes | 23,900 | 28,903 |
| Library fund | 5,974 | 8,348 |
| Business associates breakfast | - | 2,402 |
| Fine arts | 8,597 | 17,484 |
| Minnie Trout | - | 6,842 |
| Village center lift | - | 2,641 |
| Cultural arts society | 14,188 | 14,681 |
| Dean Kieffaber Chapel | 6,422 | - |
| CalTrans grants – vehicle purchases | - | 113,724 |
| | <u> </u> | <u> </u> |
| Total | \$ <u>379,282</u> | \$ <u>483,790</u> |

NOTE 10 – PERMANENTLY RESTRICTED NET ASSETS:

Investment income from permanently restricted net assets is available for the following purposes:

| | June 30, | |
|--|---------------------|---------------------|
| | <u>2016</u> | <u>2015</u> |
| Benevolence endowment | \$ 5,849,804 | \$ 5,797,475 |
| Benevolence annuity | 241,003 | 312,365 |
| Woods discretionary | 38,630 | 38,630 |
| Minnie A. Trout Health Services Education Fund | 180,463 | 180,463 |
| C.O.B. Ministers and Missionaries | 143,257 | 143,257 |
| Good Samaritan endowment | 406,833 | 304,693 |
| LKB professional development | 128,442 | 12,932 |
| | <u> </u> | <u> </u> |
| Total | \$ <u>6,988,432</u> | \$ <u>6,789,815</u> |

Hillcrest has borrowed from the temporarily and permanently restricted net assets to fund construction of new facilities since 2003. Hillcrest pays three percent simple interest on the borrowed funds.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 11 – DONOR-DESIGNATED ENDOWMENTS:

Hillcrest’s endowments consist of the Benevolence and Good Samaritan endowments established to provide assistance to residents. The endowments include donor restricted funds. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The board of Trustees of Hillcrest has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) 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, Hillcrest classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment and the original value of subsequent gifts to the permanent endowment. The policy of the board is that all investment income from the endowment funds are available for unrestricted assistance to residents. In accordance with UPMIFA, Hillcrest considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of Hillcrest and (7) Hillcrest’s investment policy.

Hillcrest has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that Hillcrest must hold in perpetuity or for a donor-specified period.

Endowment net asset composition by type of fund as of June 30, 2016, is as follows:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total Net Endowment Assets</u> |
|-------------------------------------|---------------------|-----------------------------------|-----------------------------------|---|
| Donor-restricted endowment funds | \$ <u>-</u> | \$ <u>-</u> | \$ <u>6,256,637</u> | \$ <u>6,256,637</u> |

Changes in endowment net assets as of June 30, 2016, are as follows:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total Net Endowment Assets</u> |
|--|---------------------|-----------------------------------|-----------------------------------|---|
| Endowment net assets, beginning of year | \$ - | \$ - | \$ 6,102,168 | \$ 6,102,168 |
| Contributions | - | - | 154,465 | 154,465 |
| Investment income | <u>-</u> | <u>-</u> | <u>4</u> | <u>4</u> |
| Endowment net assets, end of year | \$ <u>-</u> | \$ <u>-</u> | \$ <u>6,256,637</u> | \$ <u>6,256,637</u> |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 11 – DONOR-DESIGNATED ENDOWMENTS (continued):

Endowment net asset composition by type of fund as of June 30, 2015, is as follows:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total Net Endowment Assets</u> |
|-------------------------------------|---------------------|-----------------------------------|-----------------------------------|---|
| Donor-restricted endowment funds | \$ <u>-</u> | \$ <u>-</u> | \$ <u>6,102,168</u> | \$ <u>6,102,168</u> |

Changes in endowment net assets as of June 30, 2015, are as follows:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total Net Endowment Assets</u> |
|--|---------------------|-----------------------------------|-----------------------------------|---|
| Endowment net assets, beginning of year | \$ - | \$ - | \$ 6,096,396 | \$ 6,096,396 |
| Contributions | - | - | 5,597 | 5,597 |
| Investment income | <u>-</u> | <u>-</u> | <u>175</u> | <u>175</u> |
| Endowment net assets, end of year | \$ <u>-</u> | \$ <u>-</u> | \$ <u>6,102,168</u> | \$ <u>6,102,168</u> |

NOTE 12 – LEASE INCOME:

Hillcrest purchased approximately nine acres of open land in December 2001 for \$2,069,350. The land was originally leased to a nursery, pursuant to a lease dated July 9, 1998. The lease expired on July 1, 2013, and now operates on a month-to-month basis, with monthly payments of \$2,179.

On April 1, 2014, a lease agreement was entered in to with Pacific Southwest District of the Church of the Brethren. The land will be leased under a three year term with monthly payments of \$1,800. The amounts of lease revenue received in connection with the leases for the years ended June 30, 2016 and 2015, were \$48,528 and \$47,748, respectively. Future minimum lease payments are as follows:

| <u>Year Ended June 30,</u> | <u>Amount</u> |
|----------------------------|------------------|
| 2017 | \$ <u>16,200</u> |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 13 – PENSION AND ANNUITY PLANS:

Hillcrest provides a pension plan for employees under Section 403(b) of the Internal Revenue Code. All full-time employees are eligible to participate however, an employee must be 21 years of age and have been employed for one year in order to receive employer contributions. Employees may voluntarily contribute a portion of their salary to the plan, subject to certain limitations. Hillcrest contributed 4% and 3.5% on behalf of each eligible employee for the years ended June 30, 2016 and 2015, respectively. Hillcrest's total cost for this pension plan was \$303,957 and \$246,680 for the years ended June 30, 2016 and 2015, respectively.

NOTE 14 – RELATED PARTIES:

Hillcrest purchased general and professional liability insurance for premiums of \$216,143 and \$207,508 for the years ended June 30, 2016 and 2015, respectively. The insurance was purchased from an insurance company of which Hillcrest is a shareholder. At June 30, 2016 and 2015, Hillcrest's investment in this insurance company was \$325,443 and \$291,659, respectively. This amount is included in investments at the estimated equity value at year end.

Hillcrest purchased workers' compensation insurance for premiums of \$741,238 and \$659,302 for the years ended June 30, 2016 and 2015, respectively. The insurance was purchased through a group self-insurance program of which Hillcrest is a member. The group insurance program is governed by the California Department of Industrial Relations. A Hillcrest officer is a member of its Audit Committee.

NOTE 15 – CHARITY CARE:

Hillcrest maintains records to identify and monitor the level of charity care it provides. These records indicate the difference between Hillcrest's customary charge and the rate paid by Medi-Cal or Supplemental Security Income (SSI), as well as charity care for residents. Residents' charity care is supported through Benevolence donations and earnings on endowment resources.

The following information measures the level of voluntary charity care provided for the years ended June 30, 2016 and 2015:

| | Years Ended June 30, | |
|--------------------------------|----------------------|------------|
| | 2016 | 2015 |
| Nursing facility | \$ 136,262 | \$ 125,402 |
| Assisted living | 102,992 | 98,942 |
| Residential living | 75,153 | 64,316 |
| Related to contract residents | 314,407 | 288,660 |
| Related to community residents | 639,635 | 520,278 |
| Total | \$ 954,042 | \$ 808,938 |

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 16 – EQUIPMENT LEASE

Since July 30, 2008, Hillcrest has been party to an operating lease for a telephone system, which includes insurance and maintenance. During the year ended June 30, 2015, the lease expired and was renewed through December 15, 2015. As of December 15, 2015, the lease converted to a month-to-month lease. Amounts paid for the years ended June 30, 2016 and 2015 were \$79,014 and \$78,395, respectively.

NOTE 17 – CONTINGENCY:

Hillcrest is subject to various claims for damages that arise in the normal course of business. All claims have been referred to Hillcrest's insurance carrier and are in various stages of investigation, discovery or pretrial. In management's opinion, although the outcomes of these claims are unknown at this time, any losses that may occur would be covered by Hillcrest's insurance company, and therefore, should not have a material impact on Hillcrest's financial position or activities.

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations relate to, among other things, matters such as licensure, accreditation, and government health care program participation requirements, regulations regarding reimbursement for patient services and regulations regarding Medicare and Medi-Cal billing, fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of statutes and regulations by health care providers, which could result in expulsion from government health care programs, together with the imposition of fines and penalties, as well as significant repayments for patient services previously billed. Management believes that Hillcrest is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

NOTE 18 – MARKET VALUE ADJUSTMENT OF LAND:

Hillcrest holds land for investment in the endowment and specific purpose funds. The land was appraised in 2016 and 2015, at \$5,500,000 and \$4,173,000, respectively. The change in the appraised value of the land resulted in a \$1,327,000 unrealized gain and a \$1,323,000 unrealized gain on the statement of activities for the years ended June 30, 2016 and 2015, respectively. The land is carried at the appraised value in assets whose use is limited.

BRETHREN HILLCREST HOMES

NOTES TO FINANCIAL STATEMENTS

(Continued)

NOTE 19 – SUBSEQUENT EVENTS:

In August 2016, Hillcrest entered into a financing lease with Time Warner Cable.

Hillcrest did not have any other subsequent events through October 12, 2016, which is the date the financial statements were issued, requiring recording or disclosure in the financial statements for the year ended June 30, 2016.

Supplementary Information



HANSEN HUNTER & CO. P.C.
Certified Public Accountants

Independent Auditors' Report on Supplementary Information

To the Board of Directors
Brethren Hillcrest Homes
La Verne, California

We have audited the financial statements of Brethren Hillcrest Homes (a California not-for-profit corporation) as of and for the years ended June 30, 2016 and 2015, and have issued our report thereon dated October 12, 2016, which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of Brethren Hillcrest Homes' 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.

Hansen Hunter & Co. P.C.

October 12, 2016

BRETHREN HILLCREST HOMES
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2016

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Eliminations | Total |
|---|----------------------|---------------------------|---------------------------|-----------------------|----------------------|
| Current assets | | | | | |
| Cash and cash equivalents | \$ 8,854,112 | \$ - | \$ - | \$ - | \$ 8,854,112 |
| Accounts receivable, net | 1,032,869 | - | - | - | 1,032,869 |
| Entrance fees receivable | 1,279,534 | - | - | - | 1,279,534 |
| Interest receivable | 7,474 | - | - | - | 7,474 |
| Inventory | 51,413 | - | - | - | 51,413 |
| Prepaid expenses and deposits | 285,132 | - | - | - | 285,132 |
| Prepaid interest on restricted fund loans | 109,361 | - | - | (109,361) | - |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total current assets | 11,619,895 | - | - | (109,361) | 11,510,534 |
| Non-current assets | | | | | |
| Other inter-fund borrowings | 1,258,334 | (468,113) | (790,221) | - | - |
| Restricted funds loan | - | 206,528 | 3,714,230 | (3,920,758) | - |
| Assets whose use is limited | 10,101,532 | 3,353,589 | 4,636,824 | - | 18,091,945 |
| Investments | 378,466 | - | - | - | 378,466 |
| Debt issuance costs, net | 425,405 | - | - | - | 425,405 |
| Property, plant and equipment, net | 68,220,233 | - | - | - | 68,220,233 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total assets | \$ 92,003,865 | \$ 3,092,004 | \$ 7,560,833 | \$ (4,030,119) | \$ 98,626,583 |
| Current liabilities | | | | | |
| Accounts payable | \$ 666,138 | \$ - | \$ - | \$ - | \$ 666,138 |
| Accrued expenses | 948,072 | - | - | - | 948,072 |
| Refundable deposits | 28,195 | - | - | - | 28,195 |
| Prepaid resident service fees | 914,064 | - | - | - | 914,064 |
| Current portion of long-term debt | 1,150,000 | - | - | - | 1,150,000 |
| Entrance fee refund payable | 74,813 | - | - | - | 74,813 |
| Interest payable | 219,896 | - | - | - | 219,896 |
| Deferred revenue on restricted funds loan | - | 109,361 | - | (109,361) | - |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total current liabilities | 4,001,178 | 109,361 | - | (109,361) | 4,001,178 |
| Non-current liabilities | | | | | |
| Restricted funds loan | 3,920,758 | - | - | (3,920,758) | - |
| Long-term debt | 36,520,782 | - | - | - | 36,520,782 |
| Other long-term liability | 209,896 | - | - | - | 209,896 |
| Annuities payable | - | 572,402 | 572,401 | - | 1,144,803 |
| Repayable entrance fees | 1,068,684 | - | - | - | 1,068,684 |
| Deferred revenue from advance fees | 28,466,259 | - | - | - | 28,466,259 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total liabilities | 74,187,557 | 681,763 | 572,401 | (4,030,119) | 71,411,602 |
| Net assets | | | | | |
| Unrestricted | 17,816,308 | - | - | - | 17,816,308 |
| Temporarily restricted | - | 2,410,241 | - | - | 2,410,241 |
| Permanently restricted | - | - | 6,988,432 | - | 6,988,432 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total net assets | 17,816,308 | 2,410,241 | 6,988,432 | - | 27,214,981 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total liabilities and net assets | \$ 92,003,865 | \$ 3,092,004 | \$ 7,560,833 | \$ (4,030,119) | \$ 98,626,583 |

See independent auditors' report on supplementary information.

BRETHREN HILLCREST HOMES
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2015

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Eliminations | Total |
|---|----------------------|---------------------------|---------------------------|-----------------------|----------------------|
| Current assets | | | | | |
| Cash and cash equivalents | \$ 8,124,358 | \$ - | \$ - | \$ - | \$ 8,124,358 |
| Accounts receivable, net | 916,954 | - | - | - | 916,954 |
| Entrance fees receivable | 788,101 | - | - | - | 788,101 |
| Interest receivable | 17,388 | - | - | - | 17,388 |
| Inventory | 42,863 | - | - | - | 42,863 |
| Prepaid expenses and deposits | 247,822 | - | - | - | 247,822 |
| Prepaid interest on restricted fund loans | 105,503 | - | - | (105,503) | - |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total current assets | 10,242,989 | - | - | (105,503) | 10,137,486 |
| Non-current assets | | | | | |
| Other inter-fund borrowings | 966 | 6,032 | (6,998) | - | - |
| Restricted funds loan | - | 206,528 | 3,714,230 | (3,920,758) | - |
| Assets whose use is limited | 9,848,770 | 2,960,108 | 3,742,600 | - | 16,551,478 |
| Investments | 340,363 | - | - | - | 340,363 |
| Debt issuance costs, net | 446,765 | - | - | - | 446,765 |
| Property, plant and equipment, net | 67,857,617 | - | - | - | 67,857,617 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total assets | \$ 88,737,470 | \$ 3,172,668 | \$ 7,449,832 | \$ (4,026,261) | \$ 95,333,709 |
| Current liabilities | | | | | |
| Accounts payable | \$ 640,616 | \$ - | \$ - | \$ - | \$ 640,616 |
| Accrued expenses | 1,123,180 | - | - | - | 1,123,180 |
| Refundable deposits | 27,420 | - | - | - | 27,420 |
| Prepaid resident service fees | 190,700 | - | - | - | 190,700 |
| Current portion of long-term debt | 1,115,000 | - | - | - | 1,115,000 |
| Interest payable | 238,800 | - | - | - | 238,800 |
| Deferred revenue on restricted funds loan | - | 105,503 | - | (105,503) | - |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total current liabilities | 3,335,716 | 105,503 | - | (105,503) | 3,335,716 |
| Non-current liabilities | | | | | |
| Restricted funds loan | 3,920,758 | - | - | (3,920,758) | - |
| Long-term debt | 37,723,791 | - | - | - | 37,723,791 |
| Other long-term liability | 226,042 | - | - | - | 226,042 |
| Annuities payable | - | 660,017 | 660,017 | - | 1,320,034 |
| Repayable entrance fees | 1,221,177 | - | - | - | 1,221,177 |
| Deferred revenue from advance fees | 27,439,475 | - | - | - | 27,439,475 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total liabilities | 73,866,959 | 765,520 | 660,017 | (4,026,261) | 71,266,235 |
| Net assets | | | | | |
| Unrestricted | 14,870,511 | - | - | - | 14,870,511 |
| Temporarily restricted | - | 2,407,148 | - | - | 2,407,148 |
| Permanently restricted | - | - | 6,789,815 | - | 6,789,815 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total net assets | 14,870,511 | 2,407,148 | 6,789,815 | - | 24,067,474 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total liabilities and net assets | \$ 88,737,470 | \$ 3,172,668 | \$ 7,449,832 | \$ (4,026,261) | \$ 95,333,709 |

See independent auditors' report on supplementary information.