ANNUAL REPORT CHECKLIST

for

FISCAL YEAR ENDED:

____

PROVIDER: FOUNTAINS SENIOR LIVING HOLDINGS, LLC

FACILITY(IES): THE FOUNTAINS AT THE CARLOTTA
41-505 CARLOTTA DRIVE, PALM DESERT, CA 92211

CONTACT PERSON: BECKY ELY, REGIONAL ACCOUNTANT

TELEPHONE NO.: (520) 797-4000 or (520) 777-3523

✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓

Your complete annual report must consist of ***3 copies*** of all of the following:

✓ This cover sheet.

✓ Annual Provider Fee in the amount of: $ 8,439.85

 ✓ If applicable, late fee in the amount of: $ 0

✓ Certification by the provider's chief *executive* officer that:
 ✓ The reports are correct to the best of his/her knowledge.
 ✓ Each continuing care contract form in use or offered to new residents has been approved by the Department.
 ✓ The provider is maintaining the required *liquid reserve* and refund reserve, if applicable.

✓ Evidence of the provider's fidelity bond.

✓ The provider's audited financial statements, with an accompanying certified public accountant's opinion thereon.

✓ The provider's audited reserve reports (prepared on Department forms), with an accompanying certified public accountant's opinion thereon.

✓ The provider's "Continuing Care Retirement Community Disclosure Statement" for **each** community. (4 copies total)

The Key Indicators Report is required to be submitted within 30 days of the due date of the submission of the annual report. (4 copies total)

FORM 1-1
RESIDENT POPULATIONS

Line	Continuing Care Residents	TOTAL
[1]	Number at beginning of fiscal year	180
[2]	Number at end of fiscal year	163
[3]	Total Lines 1 & 2	343
[4]	Multiply line 3 by ".50" and enter result on line 5	0.5
[5]	Mean number of cotinuing care residents	**171.5**
	All Residents	
[6]	Number at beginning of fiscal year	256
[7]	Number at end of fiscal year	237
[8]	Total Lines 6 & 7	493
[9]	Multiply line 8 by ".50" and enter result on line 5	0.5
[10]	Mean number of all residents	**246.5**
[11]	Divide the mean number of continuing care residents (Line 5) by the mean number of all residents (Line 10) and enter the result (round to the nearest two decimal places)	**0.70**

FORM 1-2
ANNUAL PROVIDER FEE

LINE			TOTAL
[1]	Total Operating Expenses (including depreciation and debt service - interest only)		$ 13,797,489
	(a) Depreciation	$ 813,961	
	(b) Debt Service (interest only)	$ 852,782	
[2]	Subtotal (add Line 1a and 1b)		$ 1,666,743
[3]	Subtract Line 2 from Line 1 and enter result		$ 12,130,746
[4]	Percentage allocated to continuing care residents (Form 1-1, Line 11)		0.70
[5]	Total Operating Expense for Continuing Care Residents (multiply Line 3 by Line 4)		$ 8,439,850
			0.001
[6]	**Total Amount Due** (multiply Line 5 by .001)		$ 8,439.85
	NO FEE REDUCTION FOR 2012		$ -
	Total Amount Due		**$ 8,439.85**

PROVIDER: Fountains Senior Living Holdings, LLC
COMMUNITY: The Fountains at The Carlotta

ARCAPITA

RECEIVED

CONTINUING CARE CONTRACTS BRANCH

April 29, 2013

California Department of Social Services
Continuing Care Contracts Branch
744 P Street, MS 10-90
Sacramento, CA 95814
ATTN: Allison Nakatomi

Dear Ms. Nakatomi:

This letter will serve as certification on behalf of Fountains General Partner, LLC and Fountains Senior Living Holdings, LLC to the California Department of Social Services of the following matters regarding the enclosed annual report for 2012 that Fountains Senior Living Holdings, LLC is submitting as the holder of a certificate of authority for Fountains at The Carlotta:

1. The accompanying annual report is correct to the best of my knowledge.

2. Each continuing care contract form in use or offered to new residents at The Fountains at the Carlotta has been approved by the Department.

3. As of December 31, 2012, Fountains Senior Living Holdings, LLC did maintain the liquid reserves required by California law, which are reflected on the Fountains Senior Living Holdings, LLC consolidated audited financials for the year ended December 31, 2012.

Please feel free to contact us if you have any questions about our submissions.

Sincerely,

Michael K. Casey

Michael K. Casey
Vice President
U.S Senior Living Investment, LLC
(Sole member of Fountains Senior Living Holdings, LLC,
the parent of Fountains Carlotta SL, LP)

ACORD®

CERTIFICATE OF LIABILITY INSURANCE

DATE (MM/DD/YYYY) 04/29/2013

RECEIVED

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

IMPORTANT: If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy, certain policies may require an endorsement. A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).

PRODUCER
MARSH & MCLENNAN COMPANIES
1166 AVENUE OF THE AMERICAS
NEW YORK, NY 10036

077705-ALL-LIAB-13-14

CONTACT NAME:
PHONE (A/C, No, Ext): FAX (A/C, No):
E-MAIL ADDRESS:

INSURER(S) AFFORDING COVERAGE	NAIC #
INSURER A : Essex Insurance Company	39020
INSURER B : Markel Insurance Company	38970
INSURER C : N/A	N/A
INSURER D : Twin City Fire Insurance Co	29459
INSURER E :	
INSURER F :	

INSURED
THE FOUNTAINS AT CARLOTTA
41-505 CARLOTTA DRIVE
PALM DESERT, CA 92211

COVERAGES **CERTIFICATE NUMBER:** NYC-006617658-01 **REVISION NUMBER:** 1

THIS IS TO CERTIFY THAT THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED. NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS CERTIFICATE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL THE TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

INSR LTR	TYPE OF INSURANCE	ADDL INSR	SUBR WVD	POLICY NUMBER	POLICY EFF (MM/DD/YYYY)	POLICY EXP (MM/DD/YYYY)	LIMITS	
A	GENERAL LIABILITY X COMMERCIAL GENERAL LIABILITY X CLAIMS-MADE ☐ OCCUR X DEDUCTIBLE: $100,000 GEN'L AGGREGATE LIMIT APPLIES PER: ☐ POLICY ☐ PRO-JECT X LOC			CRC70000000-01	02/01/2013	02/01/2014	EACH OCCURRENCE	$ 1,000,000
							DAMAGE TO RENTED PREMISES (Ea occurrence)	$ 100,000
							MED EXP (Any one person)	$ 5,000
							PERSONAL & ADV INJURY	$ 1,000,000
							GENERAL AGGREGATE	$ 3,000,000
							PRODUCTS - COMP/OP AGG	$ Included
								$
B	AUTOMOBILE LIABILITY X ANY AUTO ☐ ALL OWNED AUTOS ☐ SCHEDULED AUTOS X HIRED AUTOS X NON-OWNED AUTOS X COMP $1,000 X COLL $1,000			CRA70000000-01	02/01/2013	02/01/2014	COMBINED SINGLE LIMIT (Ea accident)	$ 10,000,000
							BODILY INJURY (Per person)	$
							BODILY INJURY (Per accident)	$
							PROPERTY DAMAGE (Per accident)	$
								$
B	X UMBRELLA LIAB ☐ OCCUR ☐ EXCESS LIAB ☐ CLAIMS-MADE ☐ DED X RETENTION $ 10,000			CRU70000000-01	02/01/2013	02/01/2014	EACH OCCURRENCE	$ 10,000,000
							AGGREGATE	$ 10,000,000
								$
D	WORKERS COMPENSATION AND EMPLOYERS' LIABILITY Y/N ANY PROPRIETOR/PARTNER/EXECUTIVE OFFICER/MEMBER EXCLUDED? N (Mandatory in NH) If yes, describe under DESCRIPTION OF OPERATIONS below	N/A		10WEZS7370	02/01/2013	02/01/2014	X WC STATU-TORY LIMITS ☐ OTH-ER	
							E.L. EACH ACCIDENT	$ 1,000,000
							E.L. DISEASE - EA EMPLOYEE	$ 1,000,000
							E.L. DISEASE - POLICY LIMIT	$ 1,000,000
A	Professional Liability			CRC70000000-01	02/01/2013	02/01/2014	$1,000,000 Each Claim $3,000,000 Aggregate	

DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES (Attach ACORD 101, Additional Remarks Schedule, if more space is required)

CERTIFICATE HOLDER

THE STATE OF CA DEPT. OF SOCIAL SERVICES

CANCELLATION

SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS.

AUTHORIZED REPRESENTATIVE
of Marsh USA Inc.

Michaela Grasshoff

ACORD 25 (2010/05)

Bond # ONL000100972

STATE OF CALIFORNIA—HEALTH AND HUMAN SERVICES AGENCY

CALIFORNIA DEPARTMENT OF SOCIAL SERVICES
COMMUNITY CARE LICENSING

SURETY BOND

(Original sent to Regional Office)

Applicant/Licensee Name: Sunrise IV Carlotta SL, LP and Watermark Retirement Communities, Inc.

Address: 41-505 Carlotta Drive, Palm Desert, CA 92211

Bonding Company: Berkley Surety Group, Inc.

Address: 412 Mt. Kemble Ave., Suite 310N, Morristown, NJ 07960 Telephone #: (973) 775-5021

Local Agent Name: Marsh USA Telephone #: 202-263-7600

The addresses shown above for licensee and bonding company will be used for service of notices, papers, and other documents.

BE IT KNOWN THAT:

Licensee, as Principal, and Bonding Company, as Surety, are held and firmly bound to the State of California, as beneficiary, in the amount of $ $8,500.00 (Eight Thousand Five Hundred and 00/100) for the payment of which the principal and surety bind themselves, their respective heirs, successors and assigns, jointly and severally.

WHEREAS Health and Safety Code sections 1560, 1568.021, and 1569.60 each require certain applicants for licenses to file with the State Department of Social Services a surety bond; and

WHEREAS the licensee has applied to operate an *(check all that apply)*:

☐ Adult Residential, Adult Day Programs or Social Rehabilitation Facility, and the licensee handles client/resident funds in any amount; or

☑ Foster Family Home, Foster Family Agency, Group Home, Small Family Home, Residential Care Facility for Persons with Chronic, Life-Threatening Illness, or Residential Care Facility for the Elderly, and the licensee handles funds of $50 or more per client/resident or $500 or more for all clients/ residents in any month;

NOW, THEREFORE, the surety is liable on this bond in the event that the principal fails to handle faithfully and honestly the money of facility clients/residents.

The facility covered by this bond is:

Facility Name: The Fountains at the Carlotta

Facility Address: 41-505 Carlotta Drive, Palm Desert, CA 92211

Facility License Number (if facility is currently licensed): 336410693

(If other facilities are covered by this bond, specify on a separate, attached page the name, address, facility license number, and bond amount for each facility.)

Every person injured as a result of any unfaithful or dishonest handling of client money may bring an action in a proper court on the bond for the amount of damage suffered thereby to the extent covered by the bond.

The aggregate liability of the Surety for all claims against this bond shall not exceed the amount of the bond, shown above.

This bond may be canceled by the Surety in accordance with Code of Civil Procedure section 996.030, and notice of cancellation must be sent in accordance with Code of Civil Procedure section 996.320. This bond is effective 08/01/2010, and remains in effect as long as the license is valid.

I certify under penalty of perjury under the laws of the State of California that the information provided on this page and on any attachments is true and correct.

BONDING COMPANY SIGNATURE:	BOND NUMBER:	DATE:
Kellie A McKinney Kellie A. McKinney, Attorney-In-Fact	ONL000100972	June 14, 2010

LIC 402 (8/04) (PUBLIC)

NOTARY ACKNOWLEDGMENT

State of Tennessee)

County of Knox)

I certify that I know or have satisfactory evidence that Kellie A. McKinney signed this document; on oath stated that he/she was authorized to sign the document and acknowledged it as the agent or representative of the named surety company which is authorized to do business in the State of California the purposes mentioned in this document.

Dated on June 14, 2010

NOVETTA M. ANDERSON STATE OF TENNESSEE NOTARY PUBLIC KNOX COUNTY

Novetta M Anderson
Signature of Notary

My commission expires August 10, 2010

POWER OF ATTORNEY
BERKLEY REGIONAL INSURANCE COMPANY
WILMINGTON, DELAWARE

Agency No: 481
Bond Number: ONL000100972

KNOW ALL MEN BY THESE PRESENTS, that BERKLEY REGIONAL INSURANCE COMPANY (the "Company"), a corporation duly organized and existing under the laws of the State of Delaware, having its principal office in Urbandale, Iowa, has made, constituted and appointed, and does by these presents make, constitute and appoint:

Kellie A. McKinney

its true and lawful Attorney-in-Fact, to sign its name as surety only as delineated below and to execute, seal, acknowledge and deliver any and all bonds and undertakings, with the exception of Financial Guaranty Insurance, providing that no single obligation shall exceed One Million and 00/100 Dollars ($1,000,000.00), to the same extent as if such bonds had been duly executed and acknowledged by the regularly elected officers of the Company at its principal office in their own proper persons.

This Power of Attorney shall be construed and enforced in accordance with, and governed by, the laws of the State of Delaware, without giving effect to the principles of conflicts of laws thereof. This Power of Attorney is granted pursuant to the following resolutions which were duly and validly adopted at a meeting of the Board of Directors of the Company held on August 21, 2000:

"RESOLVED, that the proper officers of the Company are hereby authorized to execute powers of attorney authorizing and qualifying the attorney-in-fact named therein to execute bonds, undertakings, recognizances, or other suretyship obligations on behalf of the Company, and to affix the corporate seal of the Company to powers of attorney executed pursuant hereto; and further

RESOLVED, that such power of attorney limits the acts of those named therein to the bonds, undertakings, recognizances, or other suretyship obligations specifically named therein, and they have no authority to bind the Company except in the manner and to the extent therein stated; and further

RESOLVED, that such power of attorney revokes all previous powers issued on behalf of the attorney-in-fact named; and further

RESOLVED, that the signature of any authorized officer and the seal of the Company may be affixed by facsimile to any power of attorney or certification thereof authorizing the execution and delivery of any bond, undertaking, recognizance, or other suretyship obligation of the Company; and such signature and seal when so used shall have the same force and effect as though manually affixed. The Company may continue to use for the purposes herein stated the facsimile signature of any person or persons who shall have been such officer or officers of the Company, notwithstanding the fact that they may have ceased to be such at the time when such instruments shall be issued."

IN WITNESS WHEREOF, the Company has caused these presents to be signed and attested by its appropriate officers and its corporate seal hereunto affixed this 28 day of April, 2009.

Attest:

(Seal)

By ____________
Ira S. Lederman
Senior Vice President & Secretary

Berkley Regional Insurance Company

By ____________
Robert P. Cole
Senior Vice President

STATE OF CONNECTICUT)
) ss:
COUNTY OF FAIRFIELD)

Sworn to before me, a Notary Public in the State of Connecticut, this 28 day of April, 2009, by Robert P. Cole and Ira S. Lederman who are sworn to me to be the Senior Vice President, and the Senior Vice President and Secretary, respectively, of Berkley Regional Insurance Company.

EILEEN KILLEEN
NOTARY PUBLIC
MY COMMISSION EXPIRES JUNE 30, 2012

____
Notary Public, State of Connecticut

CERTIFICATE

I, the undersigned, Assistant Secretary of BERKLEY REGIONAL INSURANCE COMPANY, DO HEREBY CERTIFY that the foregoing is a true, correct and complete copy of the original Power of Attorney; that said Power of Attorney has not been revoked or rescinded and that the authority of the Attorney-in-Fact set forth therein, who executed the bond or undertaking to which this Power of Attorney is attached, is in full force and effect as of this date.

Given under my hand and seal of the Company, this 14 day of June, 2010.

(Seal)

____
Steven Coward

SURETY RIDER

To be attached to and form a part of

Bond No. ONL000100972

Type of Bond: Resident Trust Fund Bond

dated effective August 1, 2010
(MONTH-DAY-YEAR)

executed by Sunrise IV Carlotta SL, LP and Watermark Retirement Communities, Inc. , as Principal,
(PRINCIPAL)

and by Berkley Regional Insurance Company , as Surety,

in favor of State of California, Department of Social Services
(OBLIGEE)

in consideration of the mutual agreements herein contained the Principal and the Surety hereby consent to changing

Principal name from Sunrise IV Carlotta SL, LP and Watermark Retirement Communities, Inc. to CAR-Fountains Carlotta SL, LP and Watermark Retirement Communities, Inc.

Nothing herein contained shall vary, alter or extend any provision or condition of this bond except as herein expressly stated.

This rider is effective August 1, 2010
(MONTH-DAY-YEAR)

Signed and Sealed July 16, 2010
(MONTH-DAY-YEAR)

CAR-Fountains Carlotta SL, LP and Watermark Retirement Communities, Inc.
(PRINCIPAL)

By: ______________________
(PRINCIPAL)

Berkley Regional Insurance Companies

By: Kellie A McKinney
Kellie A. McKinney, Attorney-In-Fact

S-0443/GE 8/08

XDP

(Acknowledgement by principal, if an individual)

STATE OF .... ss:

COUNTY OF ....
(Notary's seal to be attached)

On this .... day of .... before me personally came .... to me known, who being by described in and who executed the foregoing instrument, and he acknowledged that he executed the same.

Sworn before me this .... day of ...., ...

....

Notary Public

(Acknowledgment by principal, if a partnership)

STATE OF .... ss:

COUNTY OF ....
(Notary's seal to be attached)

On this .... day of .... personally appeared before me .... member or the firm of .... to me known and known to me to be the individual described in and who executed the foregoing instrument and he acknowledged to me that he executed the same for and on behalf of said firm.

Sworn before me this .... day of ...., ...

....

Notary Public

(Acknowledgment by principal, if a corporation)

STATE OF ..Arizona.............. ss:

COUNTY OF ..Pima..............
(Notary's seal to be attached)

On this ..19th......... day of ..July................ 2010.. before me personally came ..David Barnes.. to me known to be the person duly sworn, did depose and say, that he resides in ..Pima County.................. that he is the President/CEO........... of the Watermark Retirement Communities the corporation described in and which executed the foregoing instrument; that he knew the seal of said corporation; that the seal affixed to said instrument was such corporate seal; that it was affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

Sworn before me this ....19th...................... day of ....July..................., 2010.......

Official Seal
NOTARY PUBLIC
STATE OF ARIZONA
County of Pima
ALISSA BLANCHARD
My Commission Expires May 19, 2014

....Alissa Blanchard..........

Notary Public

NOTARY ACKNOWLEDGMENT

State of Tennessee)

County of Knox)

I certify that I know or have satisfactory evidence that Kellie A. McKinney signed this document; on oath stated that he/she was authorized to sign the document and acknowledged it as the agent or representative of the named surety company which is authorized to do business in the State of California the purposes mentioned in this document.

Dated on July 16, 2010

Novetta M Anderson
Signature of Notary

NOVETTA M. ANDERSON
STATE OF TENNESSEE NOTARY PUBLIC
KNOX COUNTY

My commission expires August 10, 2010.

No. 481b

POWER OF ATTORNEY
BERKLEY REGIONAL INSURANCE COMPANY
WILMINGTON, DELAWARE

NOTICE: The warning found elsewhere in this Power of Attorney affects the validity thereof. Please review carefully.

KNOW ALL MEN BY THESE PRESENTS, that BERKLEY REGIONAL INSURANCE COMPANY (the "Company"), a corporation duly organized and existing under the laws of the State of Delaware, having its principal office in Urbandale, Iowa, has made, constituted and appointed, and does by these presents make, constitute and appoint: ***Leslie M. Patterson, Barbara A. Thompson, Kellie A. McKinney, Carolyn E. Wheeler, Novetta M. Anderson or Loretta M. Jones of National Surety Center, a Division of Marsh USA Inc. of Knoxville, TN*** its true and lawful Attorney-in-Fact, to sign its name as surety only as delineated below and to execute, seal, acknowledge and deliver any and all bonds and undertakings, with the exception of Financial Guaranty Insurance, providing that no single obligation shall exceed **Fifty Million and 00/100 Dollars ($50,000,000.00)**, to the same extent as if such bonds had been duly executed and acknowledged by the regularly elected officers of the Company at its principal office in their own proper persons.

This Power of Attorney shall be construed and enforced in accordance with, and governed by, the laws of the State of Delaware, without giving effect to the principles of conflicts of laws thereof. This Power of Attorney is granted pursuant to the following resolutions which were duly and validly adopted at a meeting of the Board of Directors of the Company held on August 21, 2000:

"**RESOLVED**, that the proper officers of the Company are hereby authorized to execute powers of attorney authorizing and qualifying the attorney-in-fact named therein to execute bonds, undertakings, recognizances, or other suretyship obligations on behalf of the Company, and to affix the corporate seal of the Company to powers of attorney executed pursuant hereto; and further

RESOLVED, that such power of attorney limits the acts of those named therein to the bonds, undertakings, recognizances, or other suretyship obligations specifically named therein, and they have no authority to bind the Company except in the manner and to the extent therein stated; and further

RESOLVED, that such power of attorney revokes all previous powers issued on behalf of the attorney-in-fact named; and further

RESOLVED, that the signature of any authorized officer and the seal of the Company may be affixed by facsimile to any power of attorney or certification thereof authorizing the execution and delivery of any bond, undertaking, recognizance, or other suretyship obligation of the Company; and such signature and seal when so used shall have the same force and effect as though manually affixed. The Company may continue to use for the purposes herein stated the facsimile signature of any person or persons who shall have been such officer or officers of the Company, notwithstanding the fact that they may have ceased to be such at the time when such instruments shall be issued."

IN WITNESS WHEREOF, the Company has caused these presents to be signed and attested by its appropriate officers and its corporate seal hereunto affixed this 1 day of April, 2010.

(Seal)

Attest:

By [signature]
Ira S. Lederman
Senior Vice President & Secretary

Berkley Regional Insurance Company

By Robert P. Cole
Robert P. Cole
Senior Vice President

WARNING: THIS POWER INVALID IF NOT PRINTED ON BLUE "BERKLEY" SECURITY PAPER.

STATE OF CONNECTICUT)
) ss:
COUNTY OF FAIRFIELD)

Sworn to before me, a Notary Public in the State of Connecticut, this 1 day of April, 2010, by Robert P. Cole and Ira S. Lederman who are sworn to me to be the Senior Vice President, and the Senior Vice President and Secretary, respectively, of Berkley Regional Insurance Company.

EILEEN KILLEEN
NOTARY PUBLIC
MY COMMISSION EXPIRES JUNE 30, 2012

Eileen Killeen
Notary Public, State of Connecticut

CERTIFICATE

I, the undersigned, Assistant Secretary of BERKLEY REGIONAL INSURANCE COMPANY, DO HEREBY CERTIFY that the foregoing is a true, correct and complete copy of the original Power of Attorney; that said Power of Attorney has not been revoked or rescinded and that the authority of the Attorney-in-Fact set forth therein, who executed the bond or undertaking to which this Power of Attorney is attached, is in full force and effect as of this date.

Given under my hand and seal of the Company, this 16 day of July, 2010.

(Seal)

Steven Coward
Steven Coward

Inquiry and Notification Rider

Berkley Surety Group, LLC is the affiliated underwriting manager for all of the surety business of the following affiliated companies: Acadia Insurance Company, Berkley Regional Insurance Company, Carolina Casualty Insurance Company, Union Standard Insurance Company, Union Insurance Company and Continental Western Group Insurance Company.

To verify the authenticity of this bond please call:
(973) 775-5021 or Telefax (973) 775-5024

Any written notices, inquiries, claims or demands to the surety on the bond to which this Rider is attached should be directed to:

Berkley Surety Group, LLC
412 Mt. Kemble Ave.
Suite 310N
Morristown, NJ 07960
Attention: Surety Claims Department

Or

Telefax: **(866) 408-2421**

Please include with all notices the bond number and the name of the principal on the bond. Where a claim is being asserted please set forth generally the basis of the claim. In the case of a payment or performance bond please identify the project to which the bond pertains.

BERKLEY SURETY GROUP

KPMG

KPMG LLP
Suite 800
60 East Rio Salado Parkway
Tempe, AZ 85281-9125

RECEIVED
MAY 01 2013
CONTINUING CARE
CONTRACTS BRANCH

Independent Auditors' Report on Supplementary Information

The Partners
Fountains Carlotta SL, L.P.:

We have audited the financial statements of Fountains Carlotta SL, L.P. (an indirect wholly owned subsidiary of Fountains Senior Living Holdings, LLC) as of and for the year ended December 31, 2012, and have issued our report thereon dated April 24, 2013 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 accompanying Forms 5-1 through 5-5 (the Forms) are presented for the purpose of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Forms are fairly stated in all material respects in relation to the financial statements as a whole.

Restriction of Use

Our report is intended solely for the information and use of Fountains Carlotta SL, L.P. and the California Department of Social Services and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Phoenix, Arizona
April 24, 2013

Form 5-1

Fountains Carlotta SL, L.P.

Long-Term Debt Incurred

In a Prior Fiscal Year

(Including Balloon Debt)

Long-term debt obligation	(a) Date incurred	(b) Principal paid during fiscal year	(c) Interest paid during fiscal year	(d) Credit enhancement premiums paid in fiscal year	(e) Total paid (columns (b)+(c)+(d))
1	7/1/2005	$ 499,948	1,095,473	—	1,595,421
Total			$ 1,095,473	—	1,595,421
					(Transfer this amount to Form 5-3, Line 1)

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

Provider: Fountains Senior Living Holdings, LLC

Community: The Fountains at The Carlotta

Form 5-2

Fountains Carlotta SL, L.P.

Long-Term Debt Incurred

During Current Fiscal Year

(Including Balloon Debt)

Long-term debt obligation	(a) Date incurred	(b) Total interest paid during fiscal year	(c) Amount of most recent payment on debt	(d) Number of Payments over next 12 months	(e) Reserve Requirements (see Instruction 5) (Columns (c) x (d))
N/A		$ —	—	—	—
Total			$ —	—	—
					(Transfer this amount to Form 5-3, Line 2)

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

Provider: Fountains Senior Living Holdings, LLC

Community: The Fountains at The Carlotta

Form 5-3

Fountains Carlotta SL, L.P.

Calculation of Long-Term Debt Reserve Amount

Line		Total
[1] Total from Form 5-1 bottom of Column (e)	$	1,595,421
[2] Total from Form 5-2 bottom of Column (e)		—
[3] Facility leasehold or rental payment paid by provider during fiscal year. (Including related payments such as lease insurance)		—
[4] Total amount required for long-term debt reserve	$	1,595,421

Provider: Fountains Senior Living Holdings, LLC

Community: The Fountains at The Carlotta

Attachment A to Form 5-4

Fountains Carlotta SL, L.P.

Year ended December 31, 2012

Line 1:		
Total operating expenses	$	12,944,707
Interest paid		1,095,473
Total operating expenses line 1	$	14,040,180
Line 2a:		
Interest paid	$	1,103,454
Less non-debt interest		(7,981)
Interest paid on long-term debt line 2a	$	1,095,473

Line 2e		Revenues per audited financial	Received from residents with continuing care contracts		Received from persons without continuing care contracts
Resident fees	$	6,090,879	4,464,986		1,625,893
Health care revenue		6,183,592	44		6,183,548
Amortization of entrance fees		1,224,595	1,224,595		—
Other income		187,106	118,765		68,341
Total operating revenue	$	13,686,172	5,808,390		7,877,782
Assisted living resident service fees				$	1,634,255
Guest food service revenue					45,518
Guest apartment					20,964
Health center (skilled nursing facility revenue)					6,177,045
Total line 2e				$	7,877,782

Form 5-5

Fountains Carlotta SL, L.P.

Annual Reserve Certification

Provider name: Fountains Senior Living Holdings, LLC

Fiscal year ended: December 31, 2012

We have reviewed our debt service reserve and operating expense reserve requirements as of, and for for the period ended December 31, 2012 and are in compliance with those requirements.

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

			Amount
[1]	Debt service reserve amount	$	1,595,421
[2]	Operating expense reserve amount		873,900
[3]	Total liquid reserve amount	$	2,469,321

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

			Amount		
	Qualifying asset description		**Debt service reserve**		**Operating reserve**
[4]	Cash and cash equivalents*	$	1,600,000		900,000
[5]	Investment securities				
[6]	Equity securities				
[7]	Unused/available lines of credit				
[8]	Unused/available letters of credit				
[9]	Debt service reserve				(not applicable)
[10]	Other: ______________________				
	______________________ (describe qualifying asset)				
	Total amount of qualifying assets Listed for liquid reserve:	[11] $	1,600,000	[12]	900,000
	Total Amount Required	[13]	1,595,421	[14]	873,900
	Surplus/(Deficiency)	[15]	4,579	[16]	26,100

* Limited cash reported at community level – Cash is reflected in consolidated financials.

Signature: Michael B. Carey
(Authorized Representative)

4/28/13
(Date)

Vice President
(Title)

Attachment B to Form 5-5

Fountains Carlotta SL, L.P.

Designated Cash Reserves

December 31, 2012

		Balance at December 31, 2012	Designated funds	Not designated	Designated use
Fountains Senior Living, Holdings, LLC:					
Wells Fargo operating account	$	5,741,780	2,000,000	3,741,780	Carlotta required reserves
US Bank Insurance Escrow		323,123	323,123	—	Potential insurance settlements
Wells Fargo Capex account		60,981	60,981	—	Capital expenditures
		6,125,884	2,384,104	3,741,780	
Fountains at Carlotta SL, LP:					
Bank of America operating account		698,929	500,000	198,929	Operating reserve
Total	$	6,824,813	2,884,104	3,940,709	

Provider: Fountains Senior Living Holdings, LLC

Community: The fountains at The Carlotta

Continuing Care Retirement Community
Disclosure Statement
General Information

04/29/2013

FACILITY NAME: The Fountains at The Carlotta
ADDRESS: 41505 Carlotta Drive, Palm Desret, CA ZIP CODE: 92211 PHONE: 706-346-5420
PROVIDER NAME: Fountains Senior Living Holdings FACILITY OPERATOR: Fountains Senior Living Holdings, LLC
RELATED FACILITIES: ______ RELIGIOUS AFFILIATION: None
YEAR OPENED: 1987 NO. OF ACRES: 20 MULTI-STORY: ☐ SINGLE STORY: ☐ BOTH: ☑
MILES TO SHOPPING CTR: 1 mile MILES TO HOSPITAL: 5 miles

NUMBER OF UNITS:

INDEPENDENT LIVING		HEALTH CARE	
APARTMENTS - STUDIO	0	ASSISTED LIVING	36
APARTMENTS – 1 BDRM	23	SKILLED NURSING	45
APARTMENTS – 2 BDRM	88	SPECIAL CARE	N/A
COTTAGES/HOUSES	63	DESCRIBE SPECIAL CARE:	N/A
% OCCUPANCY AT YEAR END	77%		

TYPE OF OWNERSHIP: ☐ NOT FOR PROFIT ☑ FOR PROFIT ☐ ACCREDITED: ☐ Y ☐ N BY: ______

FORM OF CONTRACT: ☐ LIFE CARE ☑ CONTINUING CARE ☐ FEE FOR SERVICE
☐ ASSIGN ASSETS ☐ EQUITY ☑ ENTRY FEE ☑ RENTAL

REFUND PROVISIONS (Check all that apply): ☐ 90% ☐ 75% ☑ 50% ☐ PRORATED TO 0% ☐ OTHER: ______

RANGE OF ENTRANCE FEES: $ 100,000 TO $ 215,000 **LONG-TERM CARE INSURANCE REQUIRED?** ☐ Y ☑ N

HEALTH CARE BENEFITS INCLUDED IN CONTRACT: 10 Lifecare Days

ENTRY REQUIREMENTS: MIN. AGE: 60 PRIOR PROFESSION: N/A OTHER: N/A

FACILITY SERVICES AND AMENITIES

COMMON AREA AMENITIES

	AVAILABLE	FEE FOR SERVICE
BEAUTY/BARBER SHOP	☐	☑
BILLIARD ROOM	☑	☐
BOWLING GREEN	☐	☐
CARD ROOMS	☑	☐
CHAPEL	☑	☐
COFFEE SHOP	☑	☐
CRAFT ROOMS	☑	☐
EXERCISE ROOM	☑	☐
GOLF COURSE ACCESS	☑	☐
LIBRARY	☑	☐
PUTTING GREEN	☑	☐
SHUFFLEBOARD	☑	☐
SPA	☑	☐
SWIMMING POOL-INDOOR	☐	☐
SWIMMING POOL-OUTDOOR	☑	☐
TENNIS COURT	☐	☐
WORKSHOP	☐	☐
OTHER______	☐	☐

SERVICES AVAILABLE

	INCLUDED IN FEE	FOR EXTRA CHARGE
HOUSEKEEPING TIMES/MONTH	2	
NUMBER OF MEALS/DAY	15/mo	
SPECIAL DIETS AVAILABLE	Yes	
24-HOUR EMERGENCY RESPONSE	☑	☐
ACTIVITIES PROGRAM	☑	☐
ALL UTILITIES EXCEPT PHONE	☑	☐
APARTMENT MAINTENANCE	☑	☐
CABLE TV	☑	☐
LINENS FURNISHED	☐	☐
LINENS LAUNDERED	☐	☐
MEDICATION MANAGEMENT	☐	☑
NURSING/WELLNESS CLINIC	☑	☑
PERSONAL NURSING/HOME CARE	☐	☑
TRANSPORTATION-PERSONAL	☑	☑
TRANSPORTATION-PREARRANGED	☑	☑
OTHER______	☐	☐

All providers are required by Health and Safety Code section 1789.1 to provide this report to prospective residents before executing a deposit agreement or continuing care contract, or receiving any payment. Many communities are part of multi-facility operations which may influence financial reporting. Consumers are encouraged to ask questions of the continuing care retirement community that they are considering and to seek advice from professional advisors.

PROVIDER NAME: FOUNTAINS SENIOR LIVING HOLDINGS, LLC

CCRC	Location (City)	State	Phone with Area Code
The Fountains at Bronson Place	Kalamazoo	MI	269-382-3546
The Fountains at Canterbury	Oklahoma City	OK	405-751-3600
The Fountains at The Carlotta	Palm Desert	CA	760-346-5420
The Fountains at Lake Pointe Woods	Sarasota	FL	941-929-2400
The Fountains at Washington House	Alexandria	VA	703-845-5000

MLRC (MULTI-LEVEL RETIREMENT COMMUNITIES)	City	State	Phone with Area Code
The Fountains at The Albemarle	Tarboro	NC	252-823-2799
The Fountains at Boca Ciega Bay	St. Petersburg	FL	727-381-5411
The Fountains at Crystal Lake	Crystal Lake	IL	815-455-8400
The Fountains at Franklin	Southfield	MI	248-353-2810
The Fountains at Greenbriar	Independence	MO	816-257-5100
The Fountains at La Cholla	Tucson	AZ	816-797-2001
The Fountains at Pacific Regent-Bellevue	Bellevue	WA	425-646-9808
The Fountains at Millbrook	Millbrook	NY	845-677-8550
The Fountains at Rivervue	Tuckahoe	NY	914-768-6000
The Fountains at Sea Bluffs	Dana Point	CA	949-234-3000

PROVIDER NAME: ______________________________

FINANCIAL RATIO FORMULAS

LONG-TERM DEBT TO TOTAL ASSETS RATIO

$$\frac{\text{Long-Term Debt, less Current Portion}}{\text{Total Assets}}$$

OPERATING RATIO

$$\frac{\text{Total Operating Expenses} - \text{Depreciation Expense} - \text{Amortization Expense}}{\text{Total Operating Revenues} - \text{Amortization of Deferred Revenue}}$$

DEBT SERVICE COVERAGE RATIO

$$\frac{\text{Total Excess of Revenues over Expenses} + \text{Interest, Depreciation, and Amortization Expenses} - \text{Amortization of Deferred Revenue} + \text{Net Proceeds from Entrance Fees}}{\text{Annual Debt Service}}$$

DAYS CASH ON HAND RATIO

$$\frac{\text{Unrestricted Current Cash And Investments} + \text{Unrestricted Non-Current Cash and Investments}}{(\text{Operating Expenses} - \text{Depreciation} - \text{Amortization})/365}$$

Note: These formulas are also used by the Continuing Care Accreditation Commission. For each formula, that organization also publishes annual median figures for certain continuing care retirement communities.

FORM 7-1
REPORT ON CCRC MONTHLY SERVICE FEES

	RESIDENTIAL LIVING	ASSISTED LIVING	SKILLED NURSING
[1] Monthly service fees at beginning of reporting period: (Indicate range, if applicable)	$1,695 - $2,960	$2,694 - $4,263	$8,213 - $8,821
[2] Indicate percentage of increase in fees imposed during reporting period: (Indicate range, if applicable)	3% on some, but not all residents	0.00%	0% for existing residents; Street rates higher for new admits

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

[3] Indicate the date the fee increase was implemented: IL 9/1/12; SNF no increase for existing residents, however street rates higher for new admits

[4] Check each of the appropriate boxes:

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

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

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

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

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

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

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

PROVIDER: Fountains Senior Living Holdings, Inc.

COMMUNITY: The Carlotta

The Carlotta

FORM 7-1a

REPORT ON CCRC MONTHLY SERVICE FEES

Monthly Service Fee Increase Explanation

IL Fees were increased for some, but not all, existing residents in 2012 by 3%
AL Fees were not increased for existing residents; however, street rates increased for new move-ins
SNF Fees were not increased for existing residents. However, street rates were increased for new admits.

KPMG

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

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KPMG

KPMG LLP
Suite 800
60 East Rio Salado Parkway
Tempe, AZ 85281-9125

Independent Auditors' Report

The Partners of
Fountains Carlotta SL, L.P.:

We have audited the accompanying financial statements of Fountains Carlotta SL, L.P., (an indirect wholly owned subsidiary of Fountains Senior Living Holdings, LLC), which comprise the balance sheet as of December 31, 2012, and the related statements of operations, changes in partners' deficit, and cash flows for the year 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 U.S. generally accepted accounting principles; 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 opinion.

Opinion

In our opinion, the 2012 financial statements referred to above present fairly, in all material respects, the financial position of Fountains Carlotta SL, L.P. as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

KPMG

Other Matter

The accompanying financial statements of Fountains Carlotta SL, L.P. as of December 31, 2011 and for the year then ended were audited by other auditors whose report thereon dated October 11, 2012 expressed an unmodified opinion on those financial statements.

KPMG LLP

Phoenix, Arizona
April 24, 2013

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

Balance Sheets

December 31, 2012 and 2011

Assets		**2012**	**2011**
Current assets:			
Cash	$	702,429	135,759
Accounts receivable – less allowance for doubtful accounts of $416,000 and $155,000 in 2012 and 2011, respectively		2,114,025	1,456,262
Prepaid expenses and other current assets		179,368	59,092
Total current assets		2,995,822	1,651,113
Property and equipment:			
Land and land improvements		5,813,977	5,813,977
Buildings and improvements		12,073,536	11,904,133
Furniture, fixtures, and equipment		4,622,192	3,611,294
Construction in progress		811,119	643,776
Total property and equipment		23,320,824	21,973,180
Less accumulated depreciation		(4,269,450)	(3,455,488)
Property and equipment – net		19,051,374	18,517,692
Restricted cash		5,814	7,998
Deferred financing costs – less accumulated amortization of $20,679 and $6,718 in 2012 and 2011, respectively		165,435	8,907
Total – pledged for parent company debt (notes 5 and 6)	$	22,218,445	20,185,710

(Continued)

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

Balance Sheets

December 31, 2012 and 2011

Liabilities and Partners' Deficit	**2012**	**2011**
Current liabilities:		
Accounts payable and accrued expenses	$ 1,440,570	698,351
Security and reservation deposits	55,153	40,493
Accrued interest	2,941	102,220
Refundable entrance fees	1,301,418	11,414,424
Derivative liability	29,190	321,503
Current maturities of note payable	501,074	456,526
Total current liabilities	3,330,346	13,033,517
Long-term liabilities:		
Note payable – less current maturities	23,031,989	24,098,981
Derivative liability – less current portion	13,256	—
Refundable entrance fees – less current portion	9,543,736	—
Unearned nonrefundable entrance fees	4,426,259	5,530,388
Total long-term liabilities	37,015,240	29,629,369
Total liabilities	40,345,586	42,662,886
Commitments and contingencies (note 6)		
Partners' deficit	(18,127,141)	(22,477,176)
Total	$ 22,218,445	20,185,710

See accompanying notes to financial statements.

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

Statements of Operations

Years ended December 31, 2012 and 2011

		2012	2011
Operating revenue:			
Resident fees	$	6,090,879	6,204,393
Health care revenue		6,183,592	6,059,582
Amortization of entrance fees		1,224,595	836,443
Other operating income		187,106	125,126
Total operating revenue		13,686,172	13,225,544
Operating expenses:			
Wages and benefits		5,505,006	6,000,483
Depreciation		813,961	769,163
Ancillary/therapy expenses		1,684,465	1,700,119
General and administrative		613,752	294,297
Food		619,042	579,301
Supplies		163,365	310,748
Utilities		654,036	677,351
Insurance		202,772	469,657
Taxes and license fees		361,843	338,707
Repairs and maintenance		755,256	710,144
Lease expense		38,924	52,417
Management fees		684,313	780,817
Occupancy costs		287,811	241,537
Professional services		560,161	646,332
Total operating expenses		12,944,707	13,571,073
Income (loss) from operations		741,465	(345,529)
Other (expense) income:			
Interest expense		(876,373)	(1,048,146)
Change in fair value of interest rate swap agreements		279,057	486,448
Interest income		193	202
Other income (expense)		(13,592)	6,046
Total other expense		(610,715)	(555,450)
Net income (loss)	$	130,750	(900,979)

See accompanying notes to financial statements.

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

Statements of Changes in Partners' Deficit

Years ended December 31, 2012 and 2011

Partners' deficit – December 31, 2010	$ (24,760,124)
Contributions – net	3,183,927
Net loss	(900,979)
Partners' deficit – December 31, 2011	(22,477,176)
Contributions – net	4,219,285
Net income	130,750
Partners' deficit – December 31, 2012	$ (18,127,141)

See accompanying notes to financial statements.

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

Statements of Cash Flows

Years ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from residents and third-party payors	$ 11,353,323	11,986,743
Entrance fees received	1,226,271	3,101,052
Interest received	193	202
Cash paid to suppliers and employees	(11,136,271)	(12,548,032)
Interest paid	(1,103,454)	(1,197,025)
Net cash provided by operating activities	340,062	1,342,940
Cash flows from investing activities:		
Increase in restricted cash	2,184	5,177
Purchases of property and equipment	(1,290,572)	(1,273,512)
Net cash used in investing activities	(1,288,388)	(1,268,335)
Cash flows from financing activities:		
Refunds of entrance fees	(1,541,189)	(924,048)
Principal payments on note payable	(935,568)	(565,301)
Principal payments on installment loan	(41,418)	—
Payment of refinancing costs	(186,114)	(15,625)
Contributions – net	4,219,285	1,559,890
Net cash provided by financing activities	1,514,996	54,916
Net increase in cash	566,670	129,521
Cash – beginning of year	135,759	6,238
Cash – end of year	$ 702,429	135,759

(Continued)

FOUNTAINS CARLOTTA SL, L.P.
(d/b/a The Fountains at The Carlotta)
(An Indirect Wholly Owned Subsidiary of Fountains Senior Living Holdings, LLC)

Statements of Cash Flows

Years ended December 31, 2012 and 2011

		2012	2011
Reconciliation of net income (loss) to net cash provided by operating activities:			
Net income (loss)	$	130,750	(900,979)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation		813,961	769,163
Amortization of entrance fees		(1,224,595)	(836,443)
Entrance fees received		1,226,271	3,101,052
Amortization of financing costs		29,586	6,718
Amortization of waived interest on troubled debt restructuring		(128,492)	(156,117)
Provision for bad debts		331,265	58,950
Change in fair value of interest rate swap agreements		(279,057)	(486,448)
Changes in operating assets and liabilities:			
Accounts receivable		(1,155,782)	(410,554)
Prepaid expenses and other current assets		(37,242)	206,167
Payable to parent company			—
Accounts payable and accrued expenses		714,044	(17,285)
Accrued interest		(128,175)	520
Deferred revenue		—	(9,542)
Security and reservation deposits		47,528	17,738
Net cash provided by operating activities	$	340,062	1,342,940
Supplemental disclosure of cash flow information:			
Cash paid for interest	$	1,103,454	1,197,025
Supplemental disclosures of noncash investing and financing activities:			
Entrance fee draw downs applied to accounts receivable	$	198,764	195,740
Accrued capital expenditures		90,653	62,478
Payable to parent company forgiven as a capital contribution		—	1,624,037

See accompanying notes to financial statements.

(1) Organization

Fountains Carlotta SL, L.P., d/b/a The Fountains at The Carlotta (the Partnership) (an indirect wholly owned subsidiary of Fountains Senior Living Holdings, LLC), a Delaware limited partnership, operates a continuing care retirement community located in the state of California, and is owned by Fountains General Partner, LLC (GP) as general partner with a 1% interest and Fountains Pool V, LLC, (Pool V) as limited partner with a 99% interest. Both the GP and Pool V are wholly owned by Fountains Senior Living Holdings, LLC (the Parent Company). The Partnership was created pursuant to a transaction in which the Parent Company acquired certain assets and assumed certain liabilities of 16 senior living facilities (the Facilities) in June 2005, including the facility known as The Fountains at The Carlotta. The initial members of the Parent Company were Sunrise Senior Living Investments, Inc. (SSLII), a wholly owned subsidiary of Sunrise Senior Living, Inc. (SSLI), and US Senior Living Investments, LLC (US SLI). On October 27, 2009, SSLI and US SLI entered into an agreement to transfer SSLI's 20% membership interest in the Parent Company to US SLI. At December 31, 2012 and 2011, US SLI owned 100% of the membership interest in the Parent Company.

The Partnership services the varying lifestyle needs of seniors and elderly residents by combining the services for independent living, assisted living, and skilled nursing facilities in a campus setting (the Facility). The Facility consists of 174 independent living apartments/casitas, 36 assisted living units, and 45 available licensed nursing beds, as well as a common area.

The Partnership is considered a Continuing Care Retirement Community (CCRC) as their independent living resident contracts offer the residents preferential access to assisted living or the skilled nursing facility. Once a resident permanently transfers to assisted living or the skilled nursing facility, their independent living contract is terminated and the refundable portion of the entrance fee is refunded to the resident. Assisted living and skilled nursing facility contracts are month to month. Preferential access is offered from the assisted living to the skilled nursing facility. A CCRC resident receives up to 10 free days in the skilled nursing facility per year until they permanently transfer. The skilled nursing facility is not considered to be a continued care unit.

Management of the Partnership transitioned to Watermark Retirement Communities (Watermark) on January 1, 2012. The management agreement with Watermark has an initial term of five years, and shall automatically continue thereafter for successive one-year terms, unless terminated sooner as provided for in the agreement. The agreement provides for the management fee to be paid monthly. The fee is equal to 5% of the gross income accrued for each month. Management fees incurred to Watermark totaled $684,313 in 2012.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The Partnership's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

(b) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(c) Cash

Cash consists of demand deposit accounts at financial institutions. Throughout the year, the Partnership may have cash balances in excess of federally insured amounts on deposit with various financial institutions.

(d) Accounts Receivable

Accounts receivable are stated at unpaid balances, less an allowance for doubtful accounts. The Partnership provides an allowance for doubtful accounts on its outstanding receivables balance, based on its collection history and an estimate of uncollectible accounts. Generally, accounts receivable are considered to be past due after 30 days. Accounts are written off when deemed uncollectible on a specific identification basis.

(e) Inventories

Inventories are valued at the lower of cost or market and are included in prepaid expenses and other current assets in the accompanying balance sheets. Inventories mainly consist of food, glassware, dishware, utensils, linens, and chemicals.

(f) Property and Equipment

Property and equipment are recorded at cost. Maintenance and repairs are charged to expense as incurred. The Partnership capitalizes interest during construction to the extent such assets qualify for capitalization. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, as follows:

Land improvements	10 – 15 years
Buildings and improvements	5 – 40 years
Furniture, fixtures, and equipment	3 – 10 years

Depreciation expense was $813,961 and $769,163 in 2012 and 2011, respectively.

Property and equipment are reviewed for impairment whenever events or circumstances indicate that the carrying value may not be recoverable. Impairment is recognized when the asset's expected undiscounted cash flows are not sufficient to recover its carrying amount. The Partnership measures an impairment loss for such assets by comparing the fair value of the asset to its carrying amount. As of December 31, 2012 and 2011, management estimates that the future undiscounted cash flows for its investments in property and equipment are in excess of the carrying amount recorded in the balance sheets and no impairment adjustment is required.

(Continued)

Construction in progress includes project costs related to the construction of capital improvements and renovations at the Facility. These costs are allocated to the appropriate fixed asset accounts upon the completion of construction.

(g) ***Deferred Financing Costs***

During 2012 and 2011, the Parent Company paid fees to the lender to modify the loan agreement terms. The portion of the fees allocated to the Partnership was $186,114 and $15,625 in 2012 and 2011, respectively. The allocation of fees was made in proportion to the debt allocation to the Company from the Parent Company. Amortization expenses for the years ended December 31, 2012 and 2011 were $29,586 and $6,718, respectively, and are included in interest expense in the accompanying statements of operations.

(h) ***Unearned and Refundable Entrance Fees***

The Partnership provides housing to senior residents under an entrance fee agreement whereby an agreed-upon percentage of the fee is refundable to the resident or the resident's estate upon termination of the contract or upon re-occupancy of the unit by the next resident. The contracts vary and can range from 0% to 90% refundable. The Partnership recorded the refundable portion of the entrance fee as a current liability as of December 31, 2011, as the Partnership had been unable to reasonably estimate the portion of these fees that would have needed to be refunded in the next twelve months. During the year ended December 31, 2012, and with an additional year of data, the Partnership has been able to estimate the portion of these fees expected to be returned in the following year. Accordingly, this portion has been recorded as a current liability. The remainder of the entrance fee becomes nonrefundable over time and is recorded by the Partnership as a long-term liability. The nonrefundable portion of the entrance fee is amortized into income using the straight-line method over the estimated remaining life expectancy of the resident, based upon an annually adjusted actuarial projection. The Partnership records a receivable for entrance fees when an agreement is entered into with a resident. Such receivables, totaling $168,810 and $136,800 at December 31, 2012 and 2011, respectively, are included in accounts receivable on the balance sheet.

In conjunction with the acquisition of The Fountains at The Carlotta in 2005, the Partnership assumed refundable entrance fee liabilities. Due to the uncertainty of timing of settlement of the liability, the fair value could not be reasonably estimated. As a result, the Partnership has recorded the liability at its face value in the accompanying balance sheet. At December 31, 2012 and 2011, the remaining liability totaled $3,958,870 and $4,412,751, respectively. The Partnership expects the source of repayment of refundable entrance fees to come from entrance fees received from the re-occupancy of the unit.

(i) ***Future Service Obligation***

The Partnership is a continuing care retirement community and is, therefore, obligated to provide services and the use of facilities to the residents over their remaining lives based on the terms of the continuing care contract agreements (the Care Agreements). Per the terms of these Care Agreements, as described in note 1, future services which the Partnership is obligated to provide without commensurate revenue are the 10 free days per year in skilled nursing while the resident maintains their apartment. During 2012 and 2011, the discounts provided to CCRC residents were less than $35,000 each year. When the present value of estimated costs to be incurred under the Care Agreements exceeds the present value of the estimated related revenues, such excess is accrued. In accordance with regulations governing a CCRC in the state of California, the Partnership has determined that there is no future service obligation as of December 31, 2012 and 2011.

(j) Revenue Recognition and Deferred Revenue

Resident fee revenue, including resident community fees, is recognized when services are rendered. The Partnership invoices the residents one month in advance of the services being rendered, and therefore, cash payments received for services are recorded as resident refund liabilities until the services are rendered and the revenue is earned.

Typically, nonrefundable resident community fees approximating 30 times the daily residence fee are collected for assisted living residents upon move in. The rental agreements are cancelable by residents with 30 days' notice. Resident community fees are recognized as income upon move in along with the related direct incremental costs incurred.

Health care services revenue is derived primarily from providing long-term health care services to residents. For residents under reimbursement arrangements with third-party payors, including Medicaid, Medicare, and private insurers, revenue is recorded based on contractually agreed-upon amounts on a per patient, daily basis. The Partnership records revenue from private-pay patients at the agreed-upon rate as services are performed.

Health care services rendered to Medicare beneficiaries are billed and collected based on the Prospective Payment System (PPS). Fee amounts are determined annually and are based on the care needs of the resident. As a result, PPS does not have estimated annual settlements. California Medicaid determines fee amounts annually based on information provided in submitted cost reports. The California Medicaid office performs a desk review of all submitted cost reports and they audit only selected providers. Differences between the estimated amounts accrued and final settlements are reported in operations in the year of settlement and were immaterial in 2011 and 2012. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates may change. There are no receivables or payables recorded for estimated Medicare and Medicaid settlements at December 31, 2012 and 2011. No liability has been recorded for Medicare and Medicaid settlements as settlements have historically not been material.

(k) Marketing and Advertising Costs

Costs for advertising and marketing are expensed at the time the advertising takes place. Total costs expensed during 2012 and 2011 were $141,681 and $135,880, respectively, and are included in professional services expense.

(l) ***Insurance***

As of December 31, 2012, the Partnership is insured for professional and general liability, and automobile liability, subject to deductibles per occurrence of $100,000 and $1,000, respectively. Losses subject to these deductibles are accrued based upon the aggregate liability for reported claims and an estimated liability for claims incurred but not reported. These liabilities are not discounted. The Partnership also has a guaranteed cost program for worker's compensation and employee health insurance.

(m) ***Income Taxes***

No provision has been made for federal and state income taxes, as the liability for such taxes, if any, is that of the partners and not the Partnership. The Partnership is subject to franchise taxes in the state of California where the facility is located. These taxes are expensed as incurred and are included in taxes and license fees in the accompanying statements of operations.

(n) ***Derivatives***

The Partnership accounts for its derivative instruments in accordance with Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheets at fair value. ASC 815 requires that changes in the derivative instrument's fair value be recognized currently in earnings, unless specific hedge accounting criteria are met.

As of December 31, 2012, the Parent Company's derivative instruments consist of one interest rate swap agreement that it entered into to manage its exposure to interest rate risk. The Parent Company's interest rate swap instrument was not designated as a hedge in accordance with ASC 815, and, as a result, changes in the fair value of the derivative instrument are recorded in other (expense) income. Such amounts have been allocated to the Partnership by the Parent Company as described in note 5.

(o) ***Fair Value Measurements***

Fair value is based on 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. In order to increase consistency and comparability in fair value measurements, ASC 820, *Fair Value Measurement*, establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels. These levels, in order of highest priority to lowest priority, are described below:

Level 1 – Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

Level 2 – Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3 – Unobservable inputs developed using estimates and assumptions developed by the Partnership, which reflect those that a market participant would use.

As of December 31, 2012 and 2011, the carrying amounts of certain financial instruments, including cash, restricted cash, accounts receivable, accounts payable and accrued expenses that were representative of their fair values because of the short-term maturity of these instruments.

(3) Transactions with Sunrise and Parent Company

On July 1, 2005, the Partnership entered into a management agreement with Sunrise Senior Living Management, Inc. (SSLMI), a wholly owned subsidiary of SSLI, to manage its Facility. The agreement had a term of 25 years and provided for management fees to be paid monthly. On October 27, 2009, SSLI entered into an agreement with US SLI and the Parent Company's lender to terminate the existing management agreement with SSLMI in 2010. As a result of the settlement, SSLI agreed to reduce management fees during the transition period. From October 27, 2009 through October 21, 2010, the management fee ranged from 0% to 3% of adjusted gross revenue. Effective October 22, 2010 and through 2011, the management fee was 6% of adjusted gross revenue. Total management fees incurred were $780,817 in 2011. The management agreement also provides for reimbursement to SSLMI for all direct costs of operations paid by them. The management agreement terminated effective January 1, 2012 when management transferred to Watermark.

Prior to January 1, 2012, the Partnership obtained professional and general liability coverage through Sunrise Senior Living Insurance, Inc., an affiliate of SSLI. Related payments totaled $687,673 in 2011.

The Parent Company has a furniture, fixtures, and equipment (FF&E) escrow account that is used to replace fixtures, equipment, structural elements, and other components of the Facility as required in the management agreement. Under the operating agreement, all amounts in the capital expenditure reserves for the Partnership are considered to be pooled into one account at the Parent Company level, and may be used for any of the other Facilities. The balance of the Parent Company's FF&E escrow account was $60,981 and $119,136 as of December 31, 2012 and 2011, respectively.

The Partnership and Parent Company do not settle cash received or paid in intercompany transactions at the subsidiary level; therefore, the net intercompany activity between the Parent Company and the Partnership for 2012 and 2011 has been presented as a net contribution in the statements of changes in partners' deficit for the years ended December 31, 2012 and 2011, respectively.

(4) Concentrations of Credit Risk

The Partnership grants credit without collateral to its residents, most of whom are insured under third-party agreements. The Medicare program is a large source of health care revenue for the Partnership. Revenues from the Medicare program totaled approximately $4.4 million or 32% of total revenues during 2012. Revenues from the Medicare program totaled approximately $4.4 million or 33% of total revenues during

(Continued)

2011. The mix of receivables from residents and third-party payers at December 31, 2012 and 2011 was as follows:

	2012	2011
Medicare	52.05%	45.20%
Medicaid	21.55	36.18
Private	26.40	18.62
Total	100.00%	100.00%

(5) Note Payable

At the time of the acquisition in 2005, the Parent Company obtained a loan from Nordbank with a commitment amount of $405,750,000 of which $330,750,000 was drawn on the date of acquisition. The loan is collateralized by the assets of each Facility and the total loan amount was allocated by the Parent Company to each Facility based upon the lender-appraised values at the date of acquisition. The loan was scheduled to mature on June 30, 2010; however, if the Parent Company meets certain criteria at applicable milestone dates, it can be extended three times as follows: the first extension period extends maturity by 24 months to June 30, 2012; the second extension period extends maturity by an additional 12 months to June 30, 2013; and the third extension period extends maturity by an additional six months to December 31, 2013. At December 31, 2012, the Parent Company had outstanding borrowings of $293,787,845, of which $23,318,545 has been allocated to the Partnership. At December 31, 2011, the Parent Company had outstanding borrowings of $306,574,859, of which $24,254,112 has been allocated to the Partnership.

The loan bears interest at the London InterBank Offered Rate (LIBOR) plus the stated spread. The LIBOR rate was 0.31% as of December 31, 2012 and 2011. The initial spread was 2.25%, but this increased to 3.75% effective September 28, 2012. The loan required payments of interest only for the first two years. Monthly amortization payments began on July 1, 2007 and continued through October 1, 2009. As a result of the Second Amendment and Restated Loan Agreement (the Loan Agreement) executed on October 27, 2009 (the Closing Date), the monthly amortization payments from July 1, 2009, were waived, to commence again on January 1, 2011.

The Parent Company is subject to certain debt service and other financial covenants pursuant to its long-term debt agreement described above. The Parent Company failed to meet its liquidity and Debt Service Coverage Ratio (DSCR) requirements under the Loan Agreement with Nordbank at each quarter-end in 2008 and for the quarter ended March 31, 2009. This precipitated the need for the credit agreement amendment that became effective October 26, 2009. As a result of successfully amending its credit agreement, the Parent Company's loan was modified in that default interest was waived, ongoing principal amortization was postponed for 13 months, and swap arrangements were modified.

The Parent Company determined the modification to be a troubled debt restructuring in accordance with ASC 470, *Debt*, which requires that the effects of a restructuring involving only modification of terms of a payable, and not a transfer of assets or grant of equity interest, be accounted for prospectively from the time of the restructuring, and shall not change the carrying amount of the long-term debt unless the carrying amount exceeds the total future cash payments specified by the new terms.

As the future cash payments required by the terms of the Loan Agreement exceeded the carrying value of the loan at the Closing Date, which includes principal and accrued interest less unamortized financing costs, interest expense is being accounted for prospectively using the effective interest rate, which is determined to be 3.85% annually. The default interest, which was waived as part of the 2009 loan modification, is being amortized as a credit to interest expense. The amortization during 2012 and 2011 was $128,492 and $156,117, respectively. As of December 31, 2012 and 2011, the remaining unamortized default interest is $172,903 and $301,395, respectively.

Under the amended agreement, the Parent Company was not required to meet a DSCR threshold until the quarter ended March 31, 2012. DSCR is calculated as the ratio of earnings – before the deduction of interest, taxes, depreciation and amortization, plus the net cash received and refunded for entrance fees – to principal and interest, including interest related to interest rate swap agreements, for the period. A failure to achieve a DSCR of at least 1.00:1 will constitute an event of default. In addition, beginning June 30, 2012, and semiannually thereafter on each December 31st and June 30th, the Parent Company must deliver computations of Excess Cash Flow (ECF), noting any prior prepayments from ECF, and at Nordbank's option, prepay a portion of the loan not to exceed 50% of ECF. ECF is a measure of the cumulative increase in cash from the Closing Date through the quarter preceding the measurement date, less certain adjustments.

The conditions to the first extension of the maturity date include: a) the delivery of a written notice of the Parent Company's intention to extend, b) compliance with certain reporting requirements, and c) the replacement of Sunrise Senior Living Management, Inc. (SSLMI) as manager for the Facilities, except to the extent prevented by regulatory issues affecting SSLMI, provided that the Parent Company has made, and is continuing to make, commercially reasonable efforts to resolve such regulatory issues in a prompt and diligent manner.

On June 7, 2011, the first amendment to the Loan Agreement was executed. This agreement amended the first extension period by adding an additional three months to extend the maturity date to September 30, 2012. Additionally, the definition of specified reports (defined as audited annual financial statements as well as quarterly and monthly unaudited financial statements) was modified, the requirement to transition management of the final facility was removed, and two conditions to avoid immediate default were added.

In March 2012, a nonmonetary event of default occurred related to an entity which provides a limited guarantee of the Parent Company's loan. This event of default and the default for failure to provide audited financial statements within 120 days after the close of the fiscal year were subsequently waived.

On September 28, 2012, the Second Amendment to the Loan Agreement was executed. This agreement extended the maturity date of the second extension option to December 31, 2014 and the maturity date of the third extension option to December 31, 2015. Additionally, the margin with respect to LIBOR was increased to 3.75% effective October 1, 2012. Under the new Loan Agreement, the maximum percentage of ECF was increased to 90% and the DSCR was increased to 1.15:1.0 as a condition for the third extension. Effective with this amendment, the second extension option was exercised.

Under the Loan Agreement, the Parent Company is subject to certain nonfinancial covenants. Management believes the Parent Company is in compliance with all debt covenants as of December 31, 2012 and 2011.

The fair value of the Parent Company's long-term debt, including amounts allocated to the Partnership, has been estimated based on current rates offered for debt with the same remaining maturities and comparable collateralizing assets. Changes in assumptions or methodologies used to make estimates may have a material effect on the estimated fair value. In accordance with ASC 820, the Partnership has applied Level 2 type inputs to determine that the estimated fair value of the Parent Company's long-term debt was $291,733,358 and $296,495,939, of which $23,155,476 and $23,456,737 was allocated to the Partnership, at December 31, 2012 and 2011, respectively.

Scheduled annual principal maturities of the note payable until maturity, assuming the extensions are all exercised, are as follows:

		Amount
Year ending December 31:		
2013	$	459,459
2014		540,121
2015		22,318,965
Total scheduled principal maturities		23,318,545
Unamortized waived interest		172,903
Total note payable		23,491,448
Less current maturities		(459,459)
Note payable – less current maturities	$	23,031,989

Current maturities of note payable as reflected on the balance sheet, consists of the $459,459 related to the above Loan Agreement as well as $41,615 short-term installment loan related to financing of insurance premiums.

The Parent Company had two separate interest rate swap agreements with Nordbank, which expired July 1, 2012. The Parent Company executed a new interest rate swap agreement effective September 28, 2012. None of the swap agreements are designated as a hedge in accordance with ASC 815. These interest rate swaps are held to reduce to the risk of changes in LIBOR on the interest payments on the note payable. As of December 31, 2012, they had the following characteristics:

Notional amount	Fixed pay rate	Receive variable rate	Expiration date
$ 200,000,000	0.51%	Three-month LIBOR	December 29, 2014

The fair value of the interest rate swaps at December 31, 2012 and 2011, at the Parent Company level was a liability of $534,776 and $4,063,842, respectively. As the Company's interest rate swap agreements are not traded on a market exchange, the fair values are determined through a discounted cash flow approach using market-based interest rate yield curves, which are considered Level 2 inputs in accordance with ASC 820. The fair value of the interest rate swap agreement allocated to the Partnership was $42,466 and $321,503 at December 31, 2012 and 2011, and is included in the derivative liability in the accompanying balance sheets. Changes in fair value of the interest rate swap agreements are included in other (expense) income in the accompanying statements of operations. The allocation of the derivative liability is consistent with the allocation of the loan amount to each Facility.

The Parent Company utilizes these interest-rate related derivative instruments (interest rate swap agreements) to manage its exposure on its debt instruments. The Parent Company does not enter into derivative instruments for any purpose other than to mitigate the impact of changes in interest rates on its cash flows. That is, the Parent Company does not speculate using derivative instruments.

ASC 820 requires that nonperformance risk be considered in measuring the fair value of assets and liabilities. For derivatives, nonperformance risk refers to the risk that one of the parties to a derivative transaction will be unable to perform under the contractual terms of that derivative, such as the risk that one party will be unable to make cash payments at periodic net settlement dates or upon termination. The Parent Company has considered the counterparty's credit risk as well as the effect of its own credit standing in determining the fair value of its interest rate swap agreements. The Parent Company minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties.

(6) Commitments and Contingencies

The Partnership entered into an Amended and Restated Guaranty and Pledge Agreement (Guaranty) on the Closing Date, whereby, it has unconditionally guaranteed payment of the principal and interest on the Parent Company loan described in note 5 and the related performance obligations of the Parent Company's subsidiaries under the Guaranty, as defined. The occurrence and continuance of an event of default by the Parent Company under the Loan Agreement beyond the cure period constitutes an event of default under the Guaranty. As a remedy for default, the lender may take possession, sell, lease, license, or otherwise dispose of the Partnership's facility and all other assets of the Partnership.

(Continued)

From time to time, the Partnership is involved in claims and lawsuits incidental to the ordinary course of business. While the outcome of these claims and lawsuits cannot be predicted with certainty, management of the Partnership does not believe the ultimate resolution of these matters will have a material adverse effect on the Partnership's financial statements.

The Partnership acquired the Facility subject to a potential contingent liability of $3,188,295 to refund certain entrance fees collected prior to the acquisition date. Since these fees were collected by the prior owner of the Facility and did not represent a legal obligation to the Partnership unless the residents vacated their units prior to certain contractually determined dates, no liability was recorded at the time of the acquisition. As of December 31, 2012 and 2011, the remaining amount of this contingent liability was $699,223 and $793,400, respectively. As it is not probable the Partnership will have to pay this amount, no liability has been recorded as of December 31, 2012 and 2011. The Partnership did not refund any entrance fees related to the contingent liability during the years ended December 31, 2012 and 2011.

At December 31, 2012 and 2011, the Partnership has entered into $77,000 and $7,000, respectively, in firm commitments for the completion of construction projects.

(7) Employee Benefit Plan

The Partnership participated in a 401(k) retirement plan (the Plan) under SSLI for the benefit of its employees up until December 31, 2011. Employees that complete six months of service are 18 years of age or older may participate in the Plan. Employees may make pre-tax salary deferrals of 1% to 100% of their compensation, subject to annual dollar limits determined by the Internal Revenue Service. Employer matching contributions for the Plan are on a discretionary year-end match. To receive the match employees must be actively employed as of the last day of the year. The Partnership contributed a total of approximately $8,900 during the year ended December 31, 2011.

Upon transition of management of the Facility on January 1, 2012, the Partnership offered a 401(k) retirement plan (the 401(k) Plan) under Watermark Services IV, LLC for the benefit of the employees. Employees that complete six months of service and are 21 years of age or older may participate in the 401(k) Plan. Employees may make pre-tax salary deferrals of 1% to 75% of their compensation, subject to annual dollar limits determined by the IRS. Employer matching contributions for the 401(k) Plan are on a discretionary year-end match. To receive the match employees must be actively employed as of the last day of the year. The Partnership contributed a total of approximately $8,000 during the year ended December 31, 2012, to the 401(k) Plan.

(8) Subsequent Events

In preparing the financial statements, the Company evaluated subsequent events occurring through April 24, 2013, the date the financial statements were available to be issued, in accordance with the Company's procedures related to disclosure of subsequent events.

KPMG

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

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KPMG

KPMG LLP
Suite 800
60 East Rio Salado Parkway
Tempe, AZ 85281-9125

Independent Auditors' Report

The Member
Fountains Senior Living Holdings, LLC:

We have audited the accompanying consolidated financial statements of Fountains Senior Living Holdings, LLC and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations, changes in member's deficit, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Fountains Senior Living Holdings, LLC and its subsidiaries as of December 31, 2012, and the results of their operations and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

KPMG

Other Matter

The accompanying consolidated financial statements of Fountains Senior Living Holdings, LLC and its subsidiaries as of December 31, 2011 and for the year then ended were audited by other auditors whose report thereon dated October 11, 2012 expressed an unmodified opinion on those financial statements.

KPMG LLP

Phoenix, Arizona
April 24, 2013

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2012 and 2011

Assets		**2012**	**2011**
Current assets:			
Cash and cash equivalents	$	12,775,895	10,223,555
Restricted cash		—	342,644
Accounts receivable – less allowance for doubtful accounts of $1,126,000 and $975,000 in 2012 and 2011, respectively		7,273,633	6,473,453
Prepaid expenses and other current assets		2,057,957	1,376,795
Total current assets		22,107,485	18,416,447
Property and equipment:			
Land and land improvements		71,195,735	71,141,532
Buildings and improvements		321,415,588	314,625,293
Furniture, fixtures, and equipment		36,422,779	32,532,149
Construction in progress		3,637,509	4,432,008
Total property and equipment		432,671,611	422,730,982
Less accumulated depreciation		(77,584,554)	(63,372,975)
Property and equipment – net		355,087,057	359,358,007
Restricted cash		1,319,260	7,613,187
Straight-line lease receivable		378,496	368,808
Deferred financing costs – less accumulated amortization of $254,000 and $107,000 in 2012 and 2011, respectively		2,030,820	142,516
Total	$	380,923,118	385,898,965

(Continued)

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2012 and 2011

Liabilities and Member's Deficit	**2012**	**2011**
Current liabilities:		
Accounts payable and accrued expenses	$ 14,855,626	13,527,352
Payable to Sunrise – net	—	347,400
Security and reservation deposits	760,958	979,094
Accrued interest	45,260	1,281,772
Refundable entrance fees	7,156,611	54,446,424
Resident refund liabilities	661,522	677,418
Derivative liability	367,749	4,063,841
Current maturities of note payable	6,336,811	6,144,497
Total current liabilities	30,184,537	81,467,798
Long-term liabilities:		
Note payable – less current maturities	290,243,757	304,343,000
Deferred revenue	421,321	295,864
Derivative liability – less current portion	167,027	—
Refundable entrance fees – less current portion	52,481,813	—
Unearned nonrefundable entrance fees	31,492,450	31,885,624
Total long-term liabilities	374,806,368	336,524,488
Total liabilities	404,990,905	417,992,286
Commitments and contingencies (note 9)		
Member's deficit	(24,067,787)	(32,093,321)
Total	$ 380,923,118	385,898,965

See accompanying notes to consolidated financial statements.

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended December 31, 2012 and 2011

		2012	2011
Operating revenue:			
Resident fees	$	96,913,355	93,851,338
Health care revenue		36,502,287	40,547,398
Amortization of entrance fees		6,542,993	4,170,562
Lease income		5,349,770	5,239,065
Other operating income		3,288,363	2,103,231
Total operating revenue		148,596,768	145,911,594
Operating expenses:			
Wages and benefits		55,508,902	57,929,340
Depreciation		14,324,131	12,727,354
Ancillary/therapy expenses		8,653,055	9,107,639
General and administrative		3,750,886	2,466,849
Food		9,758,396	9,792,373
Supplies		2,471,321	2,495,866
Utilities		6,831,385	7,113,880
Insurance		3,650,272	3,307,859
Taxes and license fees		4,407,989	4,639,248
Repairs and maintenance		5,127,502	4,906,967
Loss (gain) on assets disposed of		2,988	(6,258,164)
Lease expense		3,650,333	3,502,378
Management fees		7,571,224	9,082,981
Occupancy costs		2,870,571	3,293,698
Professional services		6,344,296	6,675,204
Total operating expenses		134,923,251	130,783,472
Income from operations		13,673,517	15,128,122
Other (expense) income:			
Interest expense		(11,074,202)	(13,297,556)
Change in fair value of interest rate swap agreements		3,529,065	6,377,374
Interest income		54,327	73,815
Other (expense) income		(157,173)	21,358
Total other expense		(7,647,983)	(6,825,009)
Net income	$	6,025,534	8,303,113

See accompanying notes to consolidated financial statements.

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

Consolidated Statements of Changes in Member's Deficit

Years ended December 31, 2012 and 2011

Balance – December 31, 2010	$ (40,396,434)
Net income	8,303,113
Balance – December 31, 2011	(32,093,321)
Contributions	2,000,000
Net income	6,025,534
Balance – December 31, 2012	$ (24,067,787)

See accompanying notes to consolidated financial statements.

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011

		2012	2011
Cash flows from operating activities:			
Net income	$	6,025,534	8,303,113
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation		14,324,131	12,727,354
Amortization of entrance fees		(6,542,993)	(4,170,562)
Entrance fees received		19,630,660	16,116,493
Amortization of financing and loan modification costs		396,369	107,484
Amortization of waived interest on troubled debt restructuring		(1,668,056)	(2,014,058)
Loss (gain) on sale/disposition of fixed assets		2,988	(6,258,164)
Provision for bad debts		1,268,120	434,464
Change in fair value of interest rate swap agreements		(3,529,065)	(6,377,374)
Changes in operating assets and liabilities:			
Accounts receivable		(2,384,682)	1,393,158
Prepaid expenses and other current assets		410,365	7,890
Straight-line lease receivable		(9,688)	(29,664)
Payment of financing costs		(259,726)	—
Payable to Sunrise – net		(347,400)	306,488
Accounts payable and accrued expenses		1,558,221	(28,974)
Accrued interest		(1,236,512)	(53,058)
Deferred revenue		125,457	(46,936)
Security and reservation deposits		107,182	340,987
Net cash provided by operating activities		27,870,905	20,758,641
Cash flows from investing activities:			
Decrease in restricted cash		6,636,571	3,204,977
Proceeds from insurance settlements		1,086,859	890,611
Proceeds from sale of fixed assets		132,846	9,758,388
Proceeds from sale of assets held for sale		—	6,519,622
Purchases of property and equipment		(11,505,821)	(19,833,986)
Net cash (used in) provided by investing activities		(3,649,545)	539,612

(Continued)

FOUNTAINS SENIOR LIVING HOLDINGS, LLC AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011

		2012	2011
Cash flows from financing activities:			
Payment of financing costs	$	(2,024,947)	(250,000)
Payment on notes payable		(12,787,014)	(20,856,150)
Payment on short-term installment loan		(543,386)	—
Payment of resident refund liabilities		(15,896)	(145,161)
Refunds of entrance fees		(8,297,777)	(4,719,636)
Contributions		2,000,000	—
Net cash used in financing activities		(21,669,020)	(25,970,947)
Net increase (decrease) in cash and cash equivalents		2,552,340	(4,672,694)
Cash and cash equivalents – beginning of year		10,223,555	14,896,249
Cash and cash equivalents – end of year	$	12,775,895	10,223,555
Supplemental disclosure of cash flow information – cash paid for interest	$	13,734,454	15,257,188
Supplemental disclosures of noncash investing and financing activities:			
Accrued capital expenditures	$	706,926	936,873
Security deposits applied against entrance fees		325,318	750,881
Entrance fee drawdowns applied to accounts receivable		266,140	260,433

See accompanying notes to consolidated financial statements.

(1) Organization

Sunrise IV Senior Living Holdings, LLC (Sunrise IV), a Delaware limited liability company, was formed on June 30, 2005, to acquire 16 senior living facilities (the acquisition). Sunrise IV began operations on July 1, 2005. Sunrise IV provides for the varying lifestyle needs of seniors and elderly residents by combining the services for independent living, assisted living, Alzheimer's and related dementia care, and skilled nursing facilities in a campus setting.

Sunrise Senior Living Investments, Inc. (SSLII), a wholly owned subsidiary of Sunrise Senior Living, Inc. (SSLI or Sunrise), was the managing member and held a 20% membership interest and US Senior Living Investments, LLC (US SLI), a Delaware limited liability company capitalized through a leasing arrangement entered into with US Senior Living Funding, Inc. (USLF), held an 80% membership interest in Sunrise IV through October 27, 2009. USLF is a Delaware corporation, sponsored by Arcapita Bank B.S.C.

On October 27, 2009, SSLI, SSLII, Sunrise Senior Living Management, Inc. (SSLMI), US SLI and Sunrise IV entered into an agreement (the Settlement Agreement) whereby SSLII agreed to transfer its 20% membership interest in Sunrise IV to US SLI. In addition, SSLII agreed to contribute land parcels adjacent to six of the Facilities to Sunrise IV with an estimated fair value of $7,470,000. The Settlement Agreement also provided for management of the Facilities to be transferred from SSLMI, an affiliate of SSLII, to Watermark Retirement Communities, Inc. (Watermark) starting February 1, 2010, and certain amounts owed to SSLI by Sunrise IV were forgiven. In exchange for these concessions, SSLII and SSLI were released from their obligations to guarantee the performance of Sunrise IV. US SLI, the sole member as of October 27, 2009, changed the name of Sunrise IV to Fountains Senior Living Holdings, LLC (Fountains or the Company). At December 31, 2012 and 2011, US SLI owned 100% of the membership interest in Fountains.

In addition, on October 27, 2009, US SLI and Fountains entered into an amended and restated loan agreement with HSH Nordbank AG (Nordbank). Under the terms of this amended loan agreement, US SLI was required to contribute $5 million to an operating deficit reserve (ODR) and to replenish this account as needed in an aggregate amount up to $10,000,000. As discussed in note 2(g), the requirement to hold and fund this reserve was removed under the terms of the 2012 loan amendment.

The Company owns the following 13 single-purpose limited liability companies and three single-purpose limited partnerships (collectively, the Operator Entities), which operate 16 senior living facilities (the Facilities) as follows:

Operator entity	Facility	Location
Fountains La Cholla SL, LLC	Fountains at La Cholla	Tucson, Arizona
Fountains Canterbury SL, LLC	Fountains at Canterbury	Oklahoma, Oklahoma
Fountains Albemarle SL, LLC	Fountains at Albemarle	Tarboro, North Carolina
Fountains Crystal Lake SL, LLC	Fountains at Crystal Lake	Crystal Lake, Illinois
Fountains La Jolla SL, L.P.	Fountains at La Jolla	San Diego, California
Fountains Bellevue SL, LLC	Fountains at Bellevue	Bellevue, Washington
Fountains Sea Bluffs SL, L.P.	Fountains at Sea Bluffs	Dana Point, California
Fountains Franklin SL, LLC	Fountains at Franklin	Southfield, Michigan
Fountains Millbrook SL, LLC	Fountains at Millbrook	Millbrook, New York
Fountains Lake Pointe Woods SL, LLC	Fountains at Lake Pointe Woods	Sarasota, Florida
Fountains Boca Ciega SL, LLC	Fountains at Boca Ciega Bay	St. Petersburg, Florida
Fountains Carlotta SL, L.P.	Fountains at Carlotta	Palm Desert, California
Fountains Bronson Place SL, LLC	Fountains at Bronson Place	Kalamazoo, Michigan
Fountains Washington House SL, LLC	Fountains at The Washington House	Alexandria, Virginia
Fountains Greenbriar SL, LLC	Fountains at Greenbriar	Independence, Missouri
Fountains RiverVue SL, LLC	Fountains at RiverVue	Tuckahoe, New York

During 2010, management of the Facilities was transitioned at various dates to Watermark with the exception of Fountains at Carlotta, which continued to be managed by SSLMI through December 31, 2011. Total management fees incurred under the agreements with SSMLI were $0 and $780,817 in 2012 and 2011, respectively. The management agreements also provided for reimbursement to SSLMI for all direct costs of operation. Payments to SSLMI for direct operating expenses were $309,838 and $2,743,022 in 2012 and 2011, respectively.

While under management by SSLMI, the Company obtained professional and general liability coverage through Sunrise Senior Living Insurance, Inc., an affiliate of SSLI. Related payments totaled $0 and $687,673 in 2012 and 2011, respectively.

The Company had a net payable to SSLI of $0 and $347,400 as of December 31, 2012 and 2011, respectively. These transactions are subject to the right of offset wherein any receivables from Sunrise can be offset by any payables to Sunrise, and therefore, the amounts have been presented as Payable to Sunrise – net, in the accompanying consolidated balance sheets. The amounts are noninterest bearing and due on demand.

The Company entered into management agreements with Watermark to manage each of the Facilities as they transitioned from SSLMI. The agreements have an initial term of five years from the final closing date as defined in the master management agreement, and shall thereafter automatically continue for successive one-year terms, unless sooner terminated as provided for in the agreements. The agreements provide for management fees to be paid monthly. The fee is equal to 5% of the gross income accrued for each month. Total management fees incurred under these agreements in 2012 and 2011 was $7,245,251 and $6,532,760, respectively.

These management agreements also entitle Watermark to be compensated for early termination in an amount equal to the management fee earned in the preceding 12 months for the discontinued operations if termination is effective during the second or third year of the initial term. If the effective termination is in the fourth year, the fee is 50% of the management fees earned in the preceding 12 months. As a result of the sale of the skilled nursing facilities at Fountains Crystal Lake and Fountains at La Jolla, early termination fees totaling $878,645 were incurred in 2011. There were no early termination fees incurred in 2012.

In addition to the individual facility management agreements, the Company entered into a master portfolio management agreement with Watermark. This agreement entitles the manager to receive an incentive management fee as additional compensation equal to 10% of the amount by which current cash flow for a current measurement period exceeds base cash flow for a base measurement period as defined in the agreement. The total incentive management fee incurred was $255,930 and $890,759 in 2012 and 2011, respectively.

The Company leases property to Fountains Operating Company of (NY), Inc. (FOC). FOC is the licensed operator for the Fountains at Millbrook and Fountains at RiverVue senior living facilities, which are also managed by Watermark. The lease income for 2012 and 2011 was $3,385,524 and $3,286,908, respectively. The Company had a net receivable from FOC of $46,127 and $88,711 as of December 31, 2012 and 2011, respectively.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The Company's consolidated financial statements are prepared in accordance with accounting standards generally accepted in the United States of America (GAAP). The accompanying consolidated financial statements include the consolidated accounts of Fountains and the Operator Entities after elimination of intercompany accounts and transactions.

(b) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less. Throughout the year, the Company may have cash balances in excess of federally insured amounts on deposit with various financial institutions.

(d) Accounts Receivable

Accounts receivable are stated at unpaid balances, less an allowance for doubtful accounts. The Company provides an allowance for doubtful accounts on its outstanding receivables balance based on its collection history and an estimate of uncollectible accounts. Generally, accounts receivable are considered to be past due after 30 days. Accounts are written off when deemed uncollectible on a specific identification basis.

(e) Inventories

Inventories are valued at the lower of cost or market and are included in prepaid expenses and other current assets in the accompanying consolidated balance sheets. Inventories mainly consist of food, glassware, dishware, utensils, linens and chemicals.

(f) Property and Equipment

Property and equipment are recorded at cost. Maintenance and repairs are charged to expense as incurred. The Company capitalizes interest during construction to the extent such assets qualify for capitalization. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets as follows:

Land improvements	10 – 15 years
Buildings and improvements	5 – 40 years
Furniture, fixtures, and equipment	3 – 10 years

Depreciation expense was $14,324,131 and $12,727,354 in 2012 and 2011, respectively.

Property and equipment are reviewed for impairment whenever events or circumstances indicate that the carrying value may not be recoverable. Impairment is recognized when the asset's expected undiscounted cash flows are not sufficient to recover its carrying amount. The Company measures an impairment loss for such assets by comparing the fair value of the asset to its carrying amount. As of December 31, 2012 and 2011, management believes that the future estimated undiscounted cash flows for its investments in property and equipment are in excess of the carrying amount recorded in the consolidated balance sheets, and no impairment adjustment is required.

Construction in progress includes project costs related to the construction of capital improvements and renovations at the Facilities. These costs are allocated to the appropriate fixed asset accounts upon the completion of the construction.

(g) Restricted Cash

Restricted cash includes cash escrow reserves for working capital, which are required by the State of Florida for Fountains at Lake Pointe Woods and Fountains at Boca Ciega Bay. These restricted cash amounts, which are held by state authorities, totaled $696,800 and $1,259,012 as of December 31, 2012 and 2011, respectively. The reserve requirements under state statutes are calculated by applying a mandated percentage to the applicable Facilities' net operating expenses, plus a debt service reserve, as defined. The entire $562,212 reserve for Boca Ciega Bay was released in 2012.

(Continued)

Restricted cash also includes an ODR account controlled by Nordbank's administrative agent, which was funded in conjunction with the amended loan agreement, as discussed in note 6. The balance of the ODR account was $710 and $5,212,371 as of December 31, 2012 and 2011, respectively. The ODR account requirement was removed in September 2012 as part of the second restated loan amendment, as discussed in note 5.

In addition to the working capital reserves, restricted cash includes a furniture, fixtures, and equipment (FF&E) escrow account to be used to replace fixtures, equipment, structural elements, and other components of the Facilities as required in the management agreements. The balance of the FF&E escrow account was $60,981 and $119,136 as of December 31, 2012 and 2011, respectively, and is included in restricted cash in the accompanying consolidated balance sheets.

The California Department of Social Services, related to Fountains Carlotta SL, LLC, requires funds to be set aside to meet both a debt service reserve and an operating reserve which is based on the current year debt service paid and net operating expenses incurred related to continuing care residents for 75 days. The Company designated $2,500,000 and $2,650,000 held in cash and cash equivalents to meet this reserve requirement as of December 31, 2012 and 2011, respectively.

(h) Deferred Financing Costs

During 2012 and 2011, the Company paid fees totaling $2,024,947 and $250,000, respectively, to the lender to modify the loan agreement terms. In addition to the fee paid in 2012, $259,726 was paid to reimburse for legal and other closing costs related to the loan amendment. Amortization expense for the years ended December 31, 2012 and 2011 was $396,369 and $107,484, respectively, and is included in interest expense in the accompanying consolidated financial statements.

(i) Unearned and Refundable Entrance Fees

The Company provides housing to senior residents under an entrance fee agreement at certain facilities whereby an agreed-upon percentage of the fee is refundable to the resident or the resident's estate upon termination of the contract or upon reoccupancy of the unit by the next resident. The contracts vary and can range from 0% to 90% refundable. The Company recorded the refundable portion of the entrance fee as a current liability as of December 31, 2011, as the Company had been unable to reasonably estimate the portion of these fees that would have needed to be refunded in the next twelve months. During the year ended December 31, 2012, and with an additional year of data the Company has been able to estimate the portion of these fees expected to be returned in the following year. Accordingly, this portion has been recorded as a current liability. The remainder of the entrance fee becomes nonrefundable over time, and is recorded by the Company as a long-term liability. The nonrefundable portion of the entrance fee is amortized into income using the straight-line method over the estimated remaining life expectancy of the resident, based upon an annually adjusted actuarial projection. The Company records a receivable for entrance fees when an agreement is entered into with a resident. Such receivables, totaling $235,635 and $285,877 at December 31, 2012 and 2011, respectively, are included in accounts receivable on the consolidated balance sheets.

In conjunction with the acquisition in 2005, the Company assumed refundable entrance fee liabilities at certain Facilities. Due to the uncertainty of timing of settlement of the liability, the fair value could not be reasonably estimated. As a result, the Company has recorded the liability at its face value in the accompanying consolidated balance sheets. At December 31, 2012 and 2011, the remaining liability totaled $18,823,246 and $22,170,149, respectively. The Company expects the source of repayment of refundable entrance fees to come from entrance fees received from the reoccupancy of the unit.

(j) ***Future Service Obligation***

The Company owns three Facilities where continuing care contracts were previously offered, and is, therefore, obligated to provide services and the use of facilities to the residents of these communities over their remaining lives based on the terms of the continuing care contract agreements (Care Agreements). These Facilities are known as continuing care retirement communities (CCRC). The CCRC Facilities are the Fountains at Lake Pointe Woods, Fountains at Carlotta, and Fountains at The Washington House. When the present value of estimated costs to be incurred under the Care Agreements exceeds the present value of the estimated related revenues, such excess is accrued. The obligation is discounted at 6% for both 2012 and 2011, respectively, based on a rate that reasonably reflects the Company's risk premium as determined by management. Management has determined that there is no future service obligation as of December 31, 2012 and 2011.

(k) ***Revenue'Recognition and Deferred Revenue***

Resident fee revenue, including resident community fees, is recognized when services are rendered. The Company invoices the residents one month in advance of the services being rendered, and therefore, cash payments received for services are recorded as resident refund liabilities until the services are rendered and the revenue is earned.

Typically, nonrefundable resident community fees approximating 30 to 60 times the daily residence fee are collected in rental communities upon move-in. The rental agreements are cancelable by residents with 30 days' notice. Resident community fees are recognized as income upon move in along with the related direct incremental costs incurred.

Health care services revenue is derived primarily from providing long-term health care services to residents. For residents under reimbursement arrangements with third-party payors, including Medicaid, Medicare, and private insurers, revenue is recorded based on contractually agreed-upon amounts on a per-patient, daily basis. The Company records revenue from private pay patients at the agreed upon rate as services are performed.

Health care services rendered to Medicare beneficiaries are billed and collected on a Prospective Payment System (PPS). Fee amounts are determined annually and are based on the care needs of the resident. As a result, PPS does not have estimated annual settlements. Medicaid payment methodologies vary by state. Most state Medicaid programs will perform desk reviews of all submitted cost reports and audit only selected providers. Differences between the estimated amounts accrued and final settlements are reported in operations in the year of settlement and were immaterial in 2012 and 2011. Laws and regulations governing the Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates may change. There are no receivables or payables recorded for estimated Medicare and Medicaid settlements at December 31, 2012 and 2011. No liability has been recorded for Medicare and Medicaid settlements as settlements have historically not been material.

Lease income is recognized on a straight-line basis over the terms of the respective leases.

(l) Marketing and Advertising Costs

Costs for advertising and marketing are expensed at the time the advertising takes place. Total costs expensed during 2012 and 2011 were $1,629,303 and $1,827,635, respectively, and are included in professional services expense.

(m) Insurance

The Company is insured for professional and general liability, and automobile liability, subject to deductibles per occurrence of $100,000 and $1,000, respectively. Losses subject to these deductibles are accrued based upon the aggregate liability for reported claims and an estimated liability for claims incurred but not reported. These liabilities are not discounted. The Company also has a guaranteed cost program for workers compensation and employee health insurance. For 2011, Fountains Carlotta SL, LP was insured for professional and general liability, automobile liability and workers compensation, subject to deductibles per occurrence of $25,000.

(n) Income Taxes

The Company is treated as a partnership for income tax purposes. Accordingly, no provision has been made for federal and state income taxes, as the liability for such taxes, if any, is that of the member and not the Company. The Company is subject to franchise taxes in the states of California and Michigan, where certain of the Facilities are located. These taxes are expensed as incurred and are included in taxes and license fees in the accompanying consolidated statements of operations.

(o) Derivatives

The Company accounts for its derivative instruments in accordance with Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the consolidated balance sheets at fair value. ASC 815 requires that changes in the derivative instrument's fair value be recognized currently in earnings, unless specific hedge accounting criteria are met.

The Company's current derivative instruments consist of one interest rate swap agreement that it entered into to manage its exposure to interest rate risk. These derivative instruments were not designated as hedges in accordance with ASC 815, and as a result, changes in the fair value of the derivative instruments are recorded in other expense.

(p) Fair Value Measurements

Fair value is based on 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. In order to increase consistency and comparability in fair value measurements, ASC 820, *Fair Value Measurement*, establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels. These levels, in order of highest priority to lowest priority, are described below:

Level 1 – Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities

Level 2 – Observable prices that are based on inputs not quoted on active markets, but corroborated by market data

Level 3 – Unobservable inputs developed using estimates and assumptions developed by the Company, which reflect those that a market participant would use

As of December 31, 2012 and 2011, the carrying amounts of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses which meet the definition of a financial instrument, and other liabilities were representative of their fair values because of the short-term maturity of these instruments.

(3) Concentrations of Credit Risk

The Company grants credit without collateral to its residents for amounts due under resident agreements, many of whom are insured under third-party agreements. The Medicare program is a large source of health care revenue for the Company. Revenues from the Medicare program totaled approximately $22.2 million and $25.3 million or 15% and 17% of total revenues during 2012 and 2011, respectively. The mix of receivables from residents and third-party payers as of December 31, 2012 and 2011 was as follows:

	2012	2011
Medicare	48.16%	46.53%
Medicaid	10.15	11.95
Private	41.69	41.52
Total	100.00%	100.00%

(4) Property and Equipment Sold

The Fountains at Crystal Lake skilled nursing facility and an adjacent lot, which were classified as held-for-sale in 2010, were sold on February 1, 2011. The proceeds from the sale were $6,519,622 and the recorded cost was $6,573,729 resulting in a realized loss of $54,107. During 2012 and 2011, the Crystal Lake SNF had revenues of $0 and $884,887, respectively.

The Fountains at La Jolla skilled nursing facility and an adjacent lot were sold on September 30, 2011. The proceeds from the sale were $9,685,488, the recorded cost was $3,397,345, and the gain realized was $6,288,143. During 2012 and 2011, the La Jolla SNF had revenues of $0 and $5,786,714, respectively.

(5) Note Payable

At the time of the acquisition in 2005, the Company obtained a loan from Nordbank with a commitment amount of $405,750,000, of which $330,750,000 was drawn on the date of acquisition. The loan is collateralized by the assets of each facility. The loan was scheduled to mature on June 30, 2010; however, if the Company meets certain criteria at applicable milestone dates, it can be extended three times as follows: the first extension period extends maturity by 24 months to June 30, 2012; the second extension period extends maturity by an additional 12 months to June 30, 2013; and the third extension period extends maturity by an additional 6 months to December 31, 2013. At December 31, 2012 and 2011, the Company had outstanding borrowings of $293,787,845 and $306,574,859, respectively.

The loan bears interest at London InterBank Offered Rate (LIBOR), plus the stated spread. The LIBOR rate was 0.31% as of December 31, 2012 and 2011. The initial spread was 2.25%, but this increased to 3.75% effective September 28, 2012. The loan required payments of interest only for the first two years. Monthly amortization payments began on July 1, 2007 and continued through October 1, 2009. As a result of the Second Amended and Restated Loan Agreement (the Loan Agreement) executed on October 27, 2009 (the Closing Date), the monthly amortization payments from July 1, 2009 were waived, to commence again on January 1, 2011.

The Company failed to meet its liquidity and Debt Service Coverage Ratio (DSCR) requirements under the original loan agreement with Nordbank at each quarter end in 2008 and for the quarter ended March 31, 2009. This precipitated the need for the amendment that became effective October 27, 2009. The modification resulted in the waiver of default interest, the waiver of principal amortization due July 1, 2009, the postponement of ongoing principal amortization for 13 months, modification of the covenant requirements, and the modification of the swap arrangements.

The Company determined the modification to be a troubled debt restructuring in accordance with ASC 470, *Debt*, that required the effects of a restructuring involving only modification of terms of a payable, and not a transfer of assets or grant of equity interest, be accounted for prospectively from the time of the restructuring, and shall not change the carrying amount of the long-term debt unless the carrying amount exceeds the total future cash payments specified by the new terms.

As the future cash payments required by the terms of the Loan Agreement exceeded the carrying value of the loan at the Closing Date, which includes principal and accrued interest less unamortized financing costs, interest expense is being accounted for prospectively using the effective interest rate, which is determined to be 3.85% annually. The default interest, which was waived as part of the 2009 loan modification, is being amortized as a credit to interest expense. The amortization during 2012 and 2011 was $1,668,056 and $2,014,059, respectively. As of December 31, 2012 and 2011, the remaining unamortized default interest was $2,244,583 and $3,912,638, respectively.

Under the Loan Agreement, the Company was not required to meet a DSCR threshold until the quarter ended March 31, 2012. The DSCR is calculated as the ratio of earnings – before the deduction of interest, taxes, depreciation and amortization, plus the net cash received and refunded for entrance fees – to principal and interest, including interest related to interest rate swap agreements, for the period. A failure to achieve a DSCR of at least 1.00:1 will constitute an event of default. In addition, beginning June 30, 2012, and semi-annually thereafter on each December 31st and June 30th, the Company must deliver computations of Excess Cash Flow (ECF), noting any prior prepayments from ECF, and at Nordbank's

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option, prepay a portion of the loan not to exceed 50% of ECF. ECF is a measure of the cumulative increase in cash from the Closing Date through the quarter preceding the measurement date, less certain adjustments.

The conditions to the first extension of the maturity date included a) the delivery of a written notice of the Company's intention to extend, b) compliance with certain reporting requirements, and c) the replacement of SSLMI as manager for the Facilities, except to the extent prevented by regulatory issues affecting SSLMI, provided that the Company has made, and is continuing to make, commercially reasonable efforts to resolve such regulatory issues in a prompt and diligent manner.

On June 7, 2011, the First Amendment to the Loan Agreement was executed. This agreement amended the first extension period by adding an additional three months to extend the Maturity Date to September 30, 2012. Additionally, the definition of specified reports was modified, the requirement to transition management of the final facility was removed, and two conditions to avoid immediate default were added.

In March 2012, a nonmonetary event of default occurred related to an entity which provides a limited guarantee of the Company's loan. This event of default and the default for failure to provide audited financial statements within 120 days after the close of the fiscal year were subsequently waived.

On September 28, 2012, the Second Amendment to the Loan Agreement was executed. This agreement extended the maturity date of the second extension option to December 31, 2014 and the maturity date of the third extension option to December 31, 2015. Additionally, the margin with respect to LIBOR was increased to 3.75% effective October 1, 2012. Under the new Loan Agreement, the maximum percentage of ECF was increased to 90% and the DSCR was increased to 1.15:1.0 as a condition for the third extension. Effective with this amendment, the second extension option was exercised.

Under the Loan Agreement, the Company is subject to certain nonfinancial covenants. The Company is in compliance with all debt covenants as of December 31, 2012 and 2011.

The fair value of the Company's note payable is estimated based on current rates offered for debt with the same remaining maturities and comparable collateralizing assets. Changes in assumptions or methodologies used to make estimates may have a material effect on the estimated fair value. In accordance with ASC 820, management has applied Level 2 inputs to determine that the estimated fair value of the Company's long-term debt was $291,733,358 and $296,495,939 at December 31, 2012 and 2011, respectively.

Scheduled annual principal maturities of the note payable until maturity, assuming the extensions to the Second Amendment to the Loan Agreement are all exercised, are as follows:

	Amount
Year ending December 31:	
2013	$ 5,788,671
2014	6,804,923
2015	281,194,251
Total scheduled principal maturities	293,787,845
Unamortized waived interest	2,244,583
Total note payable	296,032,428
Less current maturities	(5,788,671)
Note payable – less current maturities	$ 290,243,757

Current maturities of note payable as reflected on the balance sheet consist of the $5,788,671 related to the above loan agreement as well as $548,140 short-term installment loan related to financing of insurance premiums.

The Company had two separate interest rate swap agreements with Nordbank, which expired July 1, 2012. The Company executed a new interest rate swap agreement effective September 28, 2012. None of the swap agreements are designated as a hedge in accordance with ASC 815, *Derivatives and Hedging*. These interest rate swaps are held to reduce to the risk of changes in LIBOR on the interest payments on the note payable. As of December 31, 2012, the swap had the following characteristics:

Notional amount	Fixed pay rate	Receive variable rate	Expiration date
$ 200,000,000	0.51%	Three month LIBOR	December 29, 2014

The fair value of the interest rate swaps at December 31, 2012 and 2011 was a liability of $534,776 and $4,063,842, respectively. As the Company's interest rate swap agreements are not traded on a market exchange, the fair values are obtained from quoted prices that are determined through a discounted cash flow approach using market-based interest rate yield curves, which are considered Level 2 inputs in accordance with ASC 820. The fair value of the interest rate swap agreement is recorded in the derivative liability in the accompanying consolidated balance sheets. Changes in fair value of the interest rate swap agreements are included in other (expense) income in the accompanying consolidated statements of operations.

The Company utilizes these interest-rate related derivative instruments (interest rate swap agreements) to manage its exposure on its debt instruments. The Company does not enter into derivative instruments for any purpose other than to mitigate the impact of changes in interest rates on its cash flows. That is, the Company does not speculate using derivative instruments.

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ASC 820 requires that nonperformance risk be considered in measuring the fair value of assets and liabilities. For derivatives, nonperformance risk refers to the risk that one of the parties to a derivative transaction will be unable to perform under the contractual terms of that derivative, such as the risk that one party will be unable to make cash payments at periodic net settlement dates or upon termination. The Company has considered the counterparty's credit risk as well as the effect of its own credit standing in determining the fair value of its interest rate swap agreements. The Company minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties.

(6) Member's Deficit

The operating agreement details the commitments of the member and provides the procedures for the return of capital to the member with defined priorities. All profits and losses, net cash flow from operations and capital proceeds, if any, are to be distributed according to the priorities specified in the operating agreement. As of December 31, 2012 and 2011, US SLI is the sole member.

As required by the Loan Agreement, US SLI contributed $5 million into an ODR account that is controlled by Nordbank's administrative agent and is included in restricted cash in the accompanying consolidated financial statements. US SLI was required to replenish the ODR in an aggregate amount up to $10,000,000.

The loan amendment, discussed in note 5, eliminated the requirement to replenish the ODR. At the closing of the Second Amendment to the Loan Agreement, all the funds on deposit in the ODR account, totaling approximately $5.3 million, were applied as a repayment of the note payable. Subsequent to this closing, US SLI reimbursed the Company for fees and expenses associated with the loan amendment as an equity contribution totaling $2 million.

(7) Lease Income

The Company receives lease income from nonresidential tenants under operating leases. Future minimum lease receipts as of December 31, 2012 are as follows:

Year ending December 31:	
2013	$ 5,371,330
2014	5,502,843
2015	5,045,706
2016	2,701,049
2017	1,456,263
Thereafter	1,478,107
Total	$ 21,555,298

No single tenant accounts for more than 2.5% of the Company's total revenue in 2012 and 2011. The tenant base includes nursing homes, assisted living providers, and homeowners' associations. Future minimum lease payments do not include amounts received for reimbursement of the facility operating expenses. Additionally, future minimum lease payments do not include revenues earned from temporary tenants with lease commitments that span less than one year.

(8) Lease Expense

The Company entered into a contingent lease agreement for the use of a health center. The rent expense is based on the actual costs allocable to the premises for a lease year. There is not a fixed minimum lease payment. The lease is for a term of 99 years or the useful life of the building, whichever is shorter. The lease expense for the years ended December 31, 2012 and 2011 was $732,408 in both years, and is included in lease expense in the accompanying consolidated statements of operations.

In addition to the health center lease, the Company is obligated to reimburse the related homeowner's association (HOA) for fees charged for independent living residents. These fees include dues, basic food service fee, second person fees and parking. The fees paid to the HOA for the years ended December 31, 2012 and 2011 were $2,510,971 and $2,314,888, respectively, and are included in lease expense in the accompanying consolidated statements of operations.

(9) Commitments and Contingencies

The Company is involved in claims and lawsuits incidental to the ordinary course of business. While the outcome of these claims and lawsuits cannot be predicted with certainty, management of the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company's consolidated financial statements.

The Company acquired the Facilities subject to a potential contingent liability of $23,032,890 to refund certain entrance fees collected prior to the acquisition date. Since these fees were collected by the prior owner of the Facilities and did not represent a legal obligation to the Company unless the residents vacated their units prior to certain contractually determined dates, no liability was recorded at the time of the acquisition. As of December 31, 2012 and 2011, the remaining amount of this contingent liability was $5,152,484 and $6,621,814, respectively. As it is not probable the Company will have to pay this amount, no liability has been recorded as of December 31, 2012 and 2011.

At December 31, 2012 and 2011, the Company has entered into approximately $535,000 and $758,000, respectively, in firm commitments for the completion of construction projects.

(10) Employee Benefit Plans

The Company had a 401(k) retirement plan (the Plan) under SSLI for the benefit of the employees. Employees that complete six months of service and are 18 years of age or older may participate in the Plan. Employees may make pretax salary deferrals of 1% to 100% of their compensation, subject to annual dollar limits determined by the Internal Revenue Service (IRS). Employer matching contributions for the Plan are on a discretionary year-end match. To receive the match, employees must be actively employed as of the last day of the year. The Company contributed a total of approximately $0 and $9,000 during the years ended December 31, 2012 and 2011, respectively, to the Plan.

(Continued)

During 2010, upon transition of each of the 15 transitioned Facilities to Watermark, the Company offered a 401(k) retirement plan (the 401(k) Plan) under Watermark Services IV, LLC for the benefit of the employees. Employees that complete six months of service and are 21 years of age or older may participate in the 401(k) Plan. Employees may make pretax salary deferrals of 1% to 75% of their compensation, subject to annual dollar limits determined by the IRS. Employer matching contributions for the 401(k) Plan are on a discretionary year-end match. To receive the match, employees must be actively employed as of the last day of the year. The Company contributed a total of approximately $114,800 and $172,000 during the years ended December 31, 2012 and 2011, respectively, to the 401(k) Plan.

(11) Subsequent Events

In preparing the financial statements, the Company evaluated subsequent events occurring through April 24, 2013, the date the financial statements were available to be issued, in accordance with the Company's procedures related to disclosure of subsequent events.

Key Indicators Report

Provider: Fountains Senior Living Holdings, LLC
Community: Carlotta
Reporting Year: 2012

	2008	2009	2010	2011	2012	Forecast 2013	2014	2015	2016	2017
OPERATIONAL STATISTICS	Annual reports were not required from this licensee prior to 2009. Therefore, no prior year's activity is reported.									
1. Average Annual Occupancy by Site (%)		80%	82%	82%	82%	83%	84%	84%	85%	86%
MARGIN PROFITABILTIY INDICATORS										
2. Net Operating Margin (%)		17.97%	12.93%	3.20%	5.42%	5.42%	5.42%	5.42%	5.42%	5.42%
3. Net Operating Margin - Adjusted (%)		23.94%	24.29%	16.88%	3.19%	3.26%	3.32%	3.38%	3.44%	3.50%
LIQUIDITY INDICATORS										
4. Unrestricted Cash and Investments $		$ -	$ -	$ 135,759	$ 701,929	$ 701,929	$ 701,929	$ 701,929	$ 701,929	$ 701,929
5. Days Cash on Hand (Unrestricted) $		0.00	0.00	4.12	21.12	20.51	19.91	19.33	18.77	18.22
CAPITAL STRUCTURE INDICATORS										
6. Deferred Revaue from Entrance Fees $		$ 588,301	$ 599,210	$ 836,443	$ 1,224,595	$ 1,224,595	$ 1,224,595	$ 1,224,595	$ 1,224,595	$ 1,224,595
7. Net Annual E/F Proceeds $		$ 969,971	$ 1,868,070	$ 2,177,004	$ (314,918)	$ 928,000	$ 928,000	$ 928,000	$ 928,000	$ 928,000
8. Unrestricted Net Assets $		$ 19,087,672	$ 19,760,180	$ 20,177,665	$ 22,212,630	$ 22,212,630	$22,212,630	$22,212,630	$22,212,630	$ 22,212,630
9. Annual Capital Asset Expenditures		$ 904,183	$ 1,158,842	$ 1,273,512	$ 1,290,572	$ 1,329,289	$ 1,369,168	$ 1,410,243	$ 1,452,550	$ 1,496,127
10. Annual Debt Service Coverage - Revenue Basis (x)		2.02	1.50	0.87	0.76	0.79	0.82	0.85	0.88	0.91
11. Annual Debt Service Coverage (x)		2.62	3.07	2.23	0.56	1.37	1.40	1.43	1.46	1.49
12. Annual Debt Service/Revenue (%)		0.14	0.10	0.12	0.11	0.11	0.10	0.10	0.10	0.10
13. Average Annual Effective Interest Rate (%)		8.05%	4.64%	4.40%	3.83%	3.83%	3.83%	3.83%	3.83%	3.83%
14. Unrestricted Cash & Investments/Long Term Debt (%)		0.00%	0.00%	0.57%	3.07%	3.07%	3.07%	3.07%	3.07%	3.07%
15. Average Age of Facility (years)		23.00	24.00	25.00	26.00	27.00	28.00	29.00	30.00	31.00

Signature: Michael K Casey

Title: Vice President

Date: May 2, 2013