

Section 1: 10-K/A (10-K/A)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A (Amendment No. 1)

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM TO

Commission File Number 001-37887

MEDEQUITIES REALTY TRUST, INC.

(Exact name of Registrant as specified in its Charter)

Maryland
(State or other jurisdiction of
incorporation or organization)
3100 West End Avenue, Suite 1000
Nashville, TN
(Address of principal executive offices)

46-5477146
(I.R.S. Employer
Identification No.)

37203
(Zip Code)

Registrant's telephone number, including area code: (615) 627-4710

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock, \$0.01 par value per share

Name of Each Exchange On Which Registered
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES NO

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). YES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

As of June 30, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$358,216,529, based on the closing stock price of \$12.62 as reported on the New York Stock Exchange.

The number of shares of registrant's common stock outstanding as of February 14, 2018 was 31,886,684.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement relating to its 2018 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K. The registrant expects to file its Definitive Proxy Statement with the Securities and Exchange Commission within 120 days after December 31, 2017.

EXPLANATORY NOTE

This Amendment No. 1 to the Annual Report on Form 10-K (this “Amendment”) of MedEquities Realty Trust, Inc. (the “Company”) amends the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the Securities and Exchange Commission (the “SEC”) on February 21, 2018 (the “2017 Form 10-K”). This Amendment is being filed to include the audited financial statements of GruenePointe Holdings, LLC (“GruenePointe”) as of December 31, 2017 and 2016 and for the years ended December 31, 2017, 2016 and 2015 as Exhibit 99.1 hereto and the consents from their independent auditors as Exhibits 23.2 and 23.3 hereto. GruenePointe is the guarantor of the triple-net master lease for the Company’s Texas SNF Portfolio, which accounted for more than 20% of the Company’s total assets as of December 31, 2017; therefore, GruenePointe’s audited financial statements are being filed herewith in accordance with Section 2340 of the SEC’s Division of Corporation Finance Financial Reporting Manual.

This Amendment also is being filed to file an updated consent from KPMG LLP as Exhibit 23.1 hereto to add a reference to one of the Company’s registration statements on Form S-3, which was inadvertently omitted from Exhibit 23.1 to the 2017 Form 10-K.

In addition, as required by Rule 12b-15 of the Securities Exchange Act of 1934, as amended, updated certifications of the Company’s principal executive officer and principal financial officer are included as exhibits hereto.

Item 15 of Part IV is the only portion of the 2017 Form 10-K being amended by this Amendment. Except as described above, this Amendment does not amend, update or change the financial statements, consents or any other items or disclosures contained in the 2017 Form 10-K and does not otherwise reflect events occurring after the original filing date of the 2017 Form 10-K. Accordingly, this Amendment should be read in conjunction with the 2017 Form 10-K and the Company’s other filings with the SEC subsequent to the filing of the 2017 Form 10-K.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) (1) Financial Statements

The Consolidated Financial Statements are included in Item 8 and are filed as part of this report.

(2) Financial Statement Schedules

The Financial Statement Schedules are included in Item 8 and are filed as part of this report. All other schedules are omitted because they are not applicable or not present in amounts sufficient to require submission or the required information is shown in the Consolidated Financial Statements and the Notes thereto.

(3) Exhibits

The Exhibits are included in Item 15(b) and are incorporated by reference herein.

(b) Exhibits

| Exhibit Number | Description |
|-----------------------|--|
| 3.1 | Articles of Amendment and Restatement (Incorporated by reference to Exhibit 3.1 of the Company’s Registration Statement on Form S-11, filed on August 20, 2015). |
| 3.2 | Articles Supplementary, designating MedEquities Realty Trust, Inc.’s 12.5% Series A Redeemable Cumulative Preferred Stock (Incorporated by reference to Exhibit 3.2 of the Company’s Registration Statement on Form S-11, filed on August 20, 2015). |
| 3.3 | Articles Supplementary, designating MedEquities Realty Trust, Inc.’s 7.875% Series B Redeemable Cumulative Preferred Stock (Incorporated by reference to Exhibit 3.3 of the Company’s Registration Statement on Form S-11 filed on August 20, 2015). |
| 3.4 | Amended and Restated Bylaws (Incorporated by reference to Exhibit 3.4 of the Company’s Registration Statement on Form S-11, filed on August 20, 2015). |
| 10.1 | First Amended and Restated Agreement of Limited Partnership of MedEquities Realty Operating Partnership, LP, dated July 31, 2014 (Incorporated by reference to Exhibit 10.1 of the Company’s Registration Statement on Form S-11, filed on August 20, 2015). |

- 10.2 Amendment No. 1, dated January 28, 2015, to the First Amended and Restated Agreement of Limited Partnership of MedEquities Realty Operating Partnership, LP (Incorporated by reference to Exhibit 10.2 of the Company's Registration Statement on Form S-11, filed on August 20, 2015).
- 10.3 Amendment No. 2, dated March 10, 2015, to the First Amended and Restated Agreement of Limited Partnership of MedEquities Realty Operating Partnership, LP (Incorporated by reference to Exhibit 10.3 of the Company's Registration Statement on Form S-11, filed on August 20, 2015).
- 10.4† MedEquities Realty Trust, Inc. Amended and Restated 2014 Equity Incentive Plan (as amended and restated effective May 3, 2017) (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on May 4, 2017).
- 10.5† Form of Restricted Stock Unit Award Agreement (Incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-8, filed on October 6, 2016).
- 10.6† Form of Restricted Stock Award Agreement for Officers (Incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-8, filed on October 6, 2016).
- 10.7† Form of Restricted Stock Award Agreement for Directors (Incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-8, filed on October 6, 2016).
- 10.8† Amended and Restated Employment Agreement, dated as of September 15, 2016, by and among MedEquities Realty Trust, Inc., MedEquities Realty Operating Partnership, LP and John W. McRoberts (Incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-11/A, filed on September 19, 2016).
- 10.9† Amended and Restated Employment Agreement, dated as of September 15, 2016, by and among MedEquities Realty Trust, Inc., MedEquities Realty Operating Partnership, LP and William C. Harlan (Incorporated by reference to Exhibit 10.9 of the Company's Registration Statement on Form S-11/A, filed on September 19, 2016).
- 10.10† Amended and Restated Employment Agreement, dated as of September 15, 2016, by and among MedEquities Realty Trust, Inc., MedEquities Realty Operating Partnership, LP and Jeffery C. Walraven (Incorporated by reference to Exhibit 10.10 of the Company's Registration Statement on Form S-11/A, filed on September 19, 2016).
- 10.11† Indemnification Agreement by and between MedEquities Realty Trust, Inc. and each of its directors and officers listed on Schedule A thereto (Incorporated by reference to Exhibit 10.13 to the Company's Registration Statement on Form S-11/A, filed on September 19, 2016).
- 10.12 Master Lease, dated as of March 31, 2015, by and among MRT of La Mesa, CA – SNF, LLC, MRT of National City CA – SNF I, LLC, MRT of National City CA – SNF II, LLC and MRT of Upland CA – SNF/ALF, LLC and GHC of La Mesa, LLC, GHC of National City II, LLC, GHC of National City I, LLC, GHC of Upland SNF, LLC and GHC of Upland RCFE, LLC (Incorporated by reference to Exhibit 10.19 to the Company's Registration Statement on Form S-11/A, filed on May 5, 2016).
- 10.13 First Amendment to Master Lease, dated as of October 1, 2015, by and among MRT of La Mesa, CA – SNF, LLC, MRT of National City CA – SNF I, LLC, MRT of National City CA – SNF II, LLC, MRT of Upland CA – SNF/ALF, LLC and MRT of San Diego CA – SNF, LLC and GHC of La Mesa, LLC, GHC of National City II, LLC, GHC of National City I, LLC, GHC of Upland SNF, LLC, GHC of Upland RCFE, LLC and GHC of Kearny Mesa, LLC (Incorporated by reference to Exhibit 10.20 to the Company's Registration Statement on Form S-11/A, filed on May 5, 2016).
- 10.14 Second Amendment to Master Lease, dated as of June 8, 2016, by and among MRT of La Mesa, CA - SNF, LLC, MRT of National City CA - SNF I, LLC, MRT of National City CA - SNF II, LLC, MRT of Upland CA - SNF/ALF, LLC and MRT of San Diego CA - SNF, LLC and GHC of La Mesa, LLC, GHC of National City II, LLC, GHC of National City I, LLC, GHC of Upland SNF, LLC, GHC of Upland RCFE, LLC and GHC of Kearny Mesa, LLC (Incorporated by reference to Exhibit 10.34 to the Company's Registration Statement on Form S-11/A, filed on August 22, 2016).

- 10.15 Guaranty of Master Lease, dated as of March 31, 2015 by Life Generations Healthcare LLC in favor of MRT of La Mesa, CA – SNF, LLC, MRT of National City CA – SNF I, LLC, MRT of National City CA – SNF II, LLC and MRT of Upland CA – SNF/ALF, LLC (Incorporated by reference to Exhibit 10.21 to the Company’s Registration Statement on Form S-11/A, filed on May 5, 2016).
- 10.16 Master Lease Agreement, dated as of, 2016, by and between Lakeway Realty, L.L.C., Scott & White Hospital Round Rock and Baylor University Medical Center (Incorporated by reference to Exhibit 10.28 to the Company’s Registration Statement on Form S-11/A, filed on September 19, 2016).
- 10.17 Amended and Restated Operating Agreement of Lakeway Realty, L.L.C., dated as of March 20, 2015 (Incorporated by reference to Exhibit 10.25 to the Company’s Registration Statement on Form S-11/A, filed on May 5, 2016).
- 10.18 BlueMountain Rights Agreement, dated as of July 25, 2014, by and between MedEquities Realty Trust, Inc. and BlueMountain Capital Management, LLC (Incorporated by reference to Exhibit 10.25 of the Company’s Registration Statement on Form S-11, filed on August 20, 2015).
- 10.19 Purchase and Sale Agreement, dated as of July 29, 2015, by and among GruenePointe Acquisition I, LLC, MRT of San Antonio TX – SNF I, LLC, MRT of San Antonio TX – SNF II, LLC, MRT of Graham TX – SNF, LLC, MRT of Kemp TX – SNF, LLC, MRT of Kerens TX – SNF, LLC, MRT of Brownwood TX – SNF, LLC, MRT of El Paso TX – SNF, LLC, MRT of Kaufman TX – SNF, LLC, MRT of Longview TX – SNF, LLC and MRT of Mt. Pleasant TX – SNF, LLC (Incorporated by reference to Exhibit 10.30 to the Company’s Registration Statement on Form S-11/A, filed on May 5, 2016).
- 10.20 Master Lease, dated July 29, 2015, by and between MRT of San Antonio TX – SNF I, LLC, MRT of San Antonio TX – SNF II, LLC, MRT of Graham TX – SNF, LLC, MRT of Kemp TX – SNF, LLC, MRT of Kerens TX – SNF, LLC, MRT of Brownwood TX – SNF, LLC, MRT of El Paso TX – SNF, LLC, MRT of Kaufman TX – SNF, LLC, MRT of Longview TX – SNF, LLC, MRT of Mt. Pleasant TX – SNF, LLC and GruenePointe 1 Graham, LLC, GruenePointe 1 El Paso, LLC, GruenePointe 1 Kerens, LLC, GruenePointe 1 Casa Rio, LLC, GruenePointe 1 River City, LLC, GruenePointe 1 Brownwood, LLC, GruenePointe 1 Longview, LLC, GruenePointe 1 Kemp, LLC, GruenePointe 1 Mt. Pleasant, LLC and GruenePointe 1 Kaufman, LLC (Incorporated by reference to Exhibit 10.31 to the Company’s Registration Statement on Form S-11/A, filed on May 5, 2016).
- 10.21 First Amendment to Master Lease, dated as of January 13, 2016, by and among MRT of San Antonio TX - SNF I, LLC, MRT of San Antonio TX - SNF II, LLC, MRT of Graham TX - SNF, LLC, MRT of Kemp TX - SNF, LLC, MRT of Kerens TX - SNF, LLC, MRT of Brownwood TX - SNF, LLC, MRT of El Paso TX - SNF, LLC, MRT of Kaufman TX - SNF, LLC, MRT of Longview TX - SNF, LLC, and MRT of Mt. Pleasant TX - SNF, LLC, and GruenePointe 1 Graham, LLC, GruenePointe 1 El Paso, LLC, GruenePointe 1 Kerens, LLC, GruenePointe 1 Casa Rio, LLC, GruenePointe 1 River City, LLC, GruenePointe 1 Brownwood, LLC, GruenePointe 1 Longview, LLC, GruenePointe 1 Kemp, LLC, GruenePointe 1 Mt. Pleasant, LLC, and GruenePointe 1 Kaufman, LLC (Incorporated by reference to Exhibit 10.32 to the Company’s Registration Statement on Form S-11/A, filed on May 5, 2016).
- 10.22 Registration Rights Agreement, dated as of July 31, 2014, by and among MedEquities Realty Trust, Inc. and FBR Capital Markets & Co. (Incorporated by reference to Exhibit 10.11 to the Company’s Registration Statement on Form S-11, filed on August 20, 2015).
- 10.23 Second Amended and Restated Credit Agreement, dated as of February 10, 2017, by and among the Operating Partnership and KeyBank National Association, as administrative agent and a lender, and the other agents and lenders part thereto (Incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K, filed on February 13, 2017).
- 10.24 Second Amended and Restated Unconditional Guaranty of Payment and Performance, dated as of February 10, 2017, by and among the Company and its subsidiaries party thereto, in favor of KeyBank National Association and the other lenders under the Amended Credit Agreement (Incorporated by reference to Exhibit 10.2 to the Company’s Current Report on Form 8-K, filed on February 13, 2017).

| | |
|-----------|---|
| 10.25 | Amended and Restated Master Lease between MRT of Las Vegas NV – ACH, LLC, MRT of Las Vegas NV – LTACH, LLC, MRT of Fort Worth TX – SNF, LLC and MRT of Spartanburg SC – SNF, LLC as Landlord, and Nashville Leasehold Interest, LLC, as Tenant, dated as of April 27, 2017 (Incorporated by reference to Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q, filed on August 8, 2017). |
| 10.26 | Master Lease Guaranty, dated as of April 27, 2017, by THI of Baltimore, Inc. in favor of MRT of Las Vegas NV – ACH, LLC, MRT of Las Vegas NV – LTACH, LLC, MRT of Fort Worth TX – SNF, LLC and MRT of Spartanburg SC – SNF, LLC as Landlord (Incorporated by reference to Exhibit 10.2 to the Company’s Quarterly Report on Form 10-Q, filed on August 8, 2017). |
| 10.27 | Letter Agreement, dated March 28, 2017, by and among the Company and certain funds managed by BlueMountain Capital Management, LLC (Incorporated by reference to Exhibit 10.4 to the Company’s Quarterly Report on Form 10-Q, filed on August 8, 2017). |
| 10.28** | First Amendment to BlueMountain Rights Agreement, dated December 29, 2017, by and between the Company and BlueMountain Capital Management, LLC. |
| 10.29** | First Amendment to the Second Amended and Restated Credit Agreement, dated December 22, 2017, by and among the Operating Partnership and KeyBank National Association, as administrative agent and a lender, and the other agents and lenders part thereto. |
| 10.30† | 2016 Form of Restricted Stock Unit Award Agreement (Incorporated by reference to Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q, filed on May 8, 2017). |
| 10.31†** | 2017 Form of Restricted Stock Unit Award Agreement. |
| 21.1** | List of subsidiaries. |
| 23.1* | Consent of KPMG. |
| 23.2* | Consent of Whitley Penn LLP. |
| 23.3* | Consent of McNair, McLemore, Middlebrooks & Co., LLC. |
| 31.1* | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 99.1* | Financial Statements of GruenePointe Holdings, LLC. |
| 101.INS** | XBRL Instance Document |
| 101.SCH** | XBRL Taxonomy Extension Schema |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase |

*Filed herewith

** Previously filed as an exhibit to the original Annual Report on Form 10-K for the year ended December 31, 2017, filed on February 21, 2018.

†Management contract or compensatory plan or arrangement.

**GRUENEPORTE HOLDINGS, LLC
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

**As of December 31, 2017 and 2016 and
Years Ended December 31, 2017, 2016, and 2015
with Reports of Independent Auditors**

**GRUENEPOINTE HOLDINGS, LLC
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

**As of December 31, 2017 and 2016 and
Years Ended December 31, 2017, 2016, and 2015
with Reports of Independent Auditors**

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REPORT OF INDEPENDENT AUDITORS

To the Members of
GruenePointe Holdings, LLC

We have audited the accompanying consolidated financial statements of GruenePointe Holdings, LLC and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, members' equity (deficit), and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects the financial position of GruenePointe Holdings, LLC and subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with GAAP.

/s/ Whitley Penn LLP
Dallas, Texas
March 30, 2018

March 10, 2016

INDEPENDENT AUDITOR'S REPORT

The Management
GruenePointe Holdings, LLC

We have audited the accompanying consolidated financial statements of GruenePointe Holdings, LLC and Subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, members' equity, and cash flows for the year ended December 31, 2015 and the period from April 21, 2014 (date of inception) through December 31, 2014, 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 accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 auditor's 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 Company'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 Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion the consolidated financial statements referred to above present fairly, in all material respects, the financial position of GruenePointe Holdings, LLC and Subsidiaries as of December 31, 2015 and 2014 and the results of its operations and cash flows for the year ended December 31, 2015 and period from April 21, 2014 (date of inception) through December 31, 2014, in accordance with accounting principles generally accepted in the United States of America.

/s/ McNair, McLemore, Middlebrooks & Co., LLC
McNAIR, McLEMORE, MIDDLEBROOKS & CO., LLC

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

| | December 31, | |
|---|----------------------|----------------------|
| | 2017 | 2016 |
| | <u> </u> | <u> </u> |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,691,519 | \$ 1,967,602 |
| Patient accounts receivable, net of allowance for doubtful accounts of \$2,239,488 in 2017 and \$741,308 in 2016 | 15,095,818 | 11,018,428 |
| Prepaid expenses and other current assets | <u>571,513</u> | <u>801,624</u> |
| Total current assets | 18,358,850 | 13,787,654 |
| Property and equipment: | | |
| Land | 2,478,592 | 2,101,000 |
| Buildings and improvements | 17,994,329 | 20,727 |
| Departmental equipment | 3,001,504 | 338,439 |
| Construction in progress | <u>-</u> | <u>4,825,618</u> |
| | 23,474,425 | 7,285,784 |
| Accumulated depreciation | <u>(220,688)</u> | <u>(53,367)</u> |
| | 23,253,737 | 7,232,417 |
| Other assets: | | |
| License | - | 1,204,226 |
| Assets limited as to use | 469,765 | 716,756 |
| Pre-construction costs | 1,637,802 | 5,712,759 |
| Deposits | <u>2,381,106</u> | <u>2,339,201</u> |
| | 4,488,673 | 9,972,942 |
| Assets held for sale | <u>3,963,687</u> | <u>-</u> |
| Total assets | <u>\$ 50,064,947</u> | <u>\$ 30,993,013</u> |

See accompanying notes to consolidated financial statements.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (continued)

| | December 31, | |
|--|----------------------|----------------------|
| | 2017 | 2016 |
| | <u> </u> | <u> </u> |
| Liabilities and Members' Equity (Deficit) | | |
| Current liabilities: | | |
| Notes payable | \$ 13,430,506 | \$ - |
| Receivables financing | 6,597,826 | 4,811,441 |
| Accounts payable | 10,582,228 | 5,377,944 |
| Related party payables | 5,184,863 | 2,823,716 |
| Accrued payroll, benefits, and taxes | 1,457,392 | 1,347,172 |
| Other accrued liabilities | 4,418,153 | 2,953,007 |
| Total current liabilities | <u>41,670,968</u> | <u>17,313,280</u> |
| Deferred lease liability | 4,386,765 | 2,754,693 |
| Deferred gain on sale/leaseback | 13,403,602 | 13,515,146 |
| Total liabilities | <u>59,461,335</u> | <u>33,583,119</u> |
| | | |
| Commitments and contingencies | | |
| Members' equity (deficit) | (9,396,388) | (2,590,106) |
| Total liabilities and members' equity (deficit) | <u>\$ 50,064,947</u> | <u>\$ 30,993,013</u> |

See accompanying notes to consolidated financial statements.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

| | Years Ended December 31, | | |
|--|---------------------------------|-----------------------|---------------------|
| | <u>2017</u> | <u>2016</u> | <u>2015</u> |
| Net patient service revenues | \$ 79,559,883 | \$ 83,638,952 | \$ 34,208,768 |
| Operating expenses: | | | |
| Nursing services | 40,749,485 | 40,257,924 | 17,428,143 |
| Medical records | 493,865 | 474,568 | - |
| Recreational and social | 1,809,007 | 989,391 | 467,073 |
| Dietary services | 4,601,031 | 4,562,663 | 1,946,750 |
| Housekeeping services | 1,667,239 | 1,697,529 | 758,823 |
| Laundry services | 690,787 | 653,137 | 256,750 |
| Repairs and maintenance | 2,649,582 | 2,384,331 | 1,028,924 |
| General and administrative | 13,823,414 | 12,287,377 | 3,615,723 |
| Facility lease | 15,727,199 | 15,727,199 | 6,583,470 |
| Property taxes and insurance | 1,708,934 | 932,003 | 472,958 |
| Interest expense | 889,710 | 568,344 | 394,188 |
| Depreciation | 168,244 | 50,831 | 2,535 |
| Management fees | 3,712,323 | 4,163,583 | 1,724,792 |
| | <u>88,690,820</u> | <u>84,748,880</u> | <u>34,680,129</u> |
| Operating loss | (9,130,937) | (1,109,928) | (471,361) |
| Other expense: | | | |
| Interest income | 7,515 | 6,479 | 7,087 |
| Other income (expense) | (582,860) | (226,380) | (396,858) |
| Total other expenses | <u>(575,345)</u> | <u>(219,901)</u> | <u>(389,771)</u> |
| Net loss | <u>(9,706,282)</u> | <u>(1,329,829)</u> | <u>(861,132)</u> |
| Net loss attributable to noncontrolling interest | 56,081 | 13,886 | 9,851 |
| Net loss attributable to the Company | <u>\$ (9,650,201)</u> | <u>\$ (1,315,943)</u> | <u>\$ (851,281)</u> |

See accompanying notes to consolidated financial statements.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY (DEFICIT)

Years Ended December 31, 2017, 2016, and 2015

| | <u>Members'</u> <u>Capital</u> | <u>Accumulated</u> <u>Deficit</u> | <u>Non-</u> <u>Controlling</u> <u>Interest</u> | <u>Total</u> |
|------------------------------|-----------------------------------|--------------------------------------|--|-----------------------|
| Balance at December 31, 2014 | \$ 695,000 | \$ (1,145) | \$ - | \$ 693,855 |
| Net loss | - | (851,281) | (9,851) | (861,132) |
| Capital contributions | 1,002,000 | - | - | 1,002,000 |
| Conversion of equity to debt | (695,000) | - | - | (695,000) |
| Balance at December 31, 2015 | <u>1,002,000</u> | <u>(852,426)</u> | <u>(9,851)</u> | <u>139,723</u> |
| Net loss | - | (1,315,943) | (13,886) | (1,329,829) |
| Distributions | - | (3,500,000) | - | (3,500,000) |
| Capital contributions | 2,100,000 | - | - | 2,100,000 |
| Balance at December 31, 2016 | <u>3,102,000</u> | <u>(5,668,369)</u> | <u>(23,737)</u> | <u>(2,590,106)</u> |
| Net loss | - | (9,650,201) | (56,081) | (9,706,282) |
| Capital contributions | 3,900,000 | - | - | 3,900,000 |
| Conversion of equity to debt | (1,000,000) | - | - | (1,000,000) |
| Balance at December 31, 2017 | <u>\$ 6,002,000</u> | <u>\$ (15,318,570)</u> | <u>\$ (79,818)</u> | <u>\$ (9,396,388)</u> |

See accompanying notes to consolidated financial statements.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Years Ended December 31, | | |
|--|--------------------------|---------------------|---------------------|
| | <u>2017</u> | <u>2016</u> | <u>2015</u> |
| Cash flows from operating activities: | | | |
| Net loss | \$ (9,706,282) | \$ (1,329,829) | \$ (861,132) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities | | | |
| Depreciation | 168,244 | 50,831 | 2,535 |
| Amortization of debt issuance costs | 135,708 | 128,125 | 15,136 |
| Bad debt expense | 4,742,677 | 2,512,356 | 345,000 |
| Recognized gain on sale/leaseback | (111,544) | (111,544) | (46,477) |
| Impairment on held for sale assets | 164,687 | - | - |
| Change in: | | | |
| Patient accounts receivable | (8,820,067) | 3,368,440 | (17,244,224) |
| Prepays and other assets | 94,403 | 1,918,711 | (2,539,391) |
| Deposits | (41,905) | (91,082) | (2,248,119) |
| Accounts payable | 7,565,431 | (1,608,290) | 6,780,414 |
| Accrued payroll, benefits, and taxes | 110,220 | (59,195) | 1,406,367 |
| Other accrued liabilities | 1,465,146 | 2,477,620 | 475,387 |
| Deferred lease liability | 1,632,072 | 1,910,634 | 844,059 |
| Net cash provided by (used in) operating activities | <u>(2,601,210)</u> | <u>9,166,777</u> | <u>(13,070,445)</u> |
| Cash flows from investing activities: | | | |
| Purchases of property and equipment and pre-construction costs | (15,038,755) | (5,564,059) | (4,096,857) |
| Funds released from (deposited to) escrow | 246,991 | 5,523,006 | (6,239,762) |
| Investment in Thirteen Moons | - | (3,500,000) | - |
| Net cash used in investing activities | <u>(14,791,764)</u> | <u>(3,541,053)</u> | <u>(10,336,619)</u> |
| Cash flows from financing activities: | | | |
| Proceeds from receivables financing | 74,793,003 | 88,191,546 | 18,664,601 |
| Payments on receivables financing | (73,006,618) | (88,631,717) | (13,412,989) |
| Debt issuance costs | - | (54,353) | (269,852) |
| Proceeds from notes payable | 12,430,506 | - | 3,450,000 |
| Principal payments on note payable | - | (3,450,000) | - |
| Proceeds from related party loans | - | - | 1,879,421 |
| Proceeds from sale/leaseback transaction | - | - | 13,673,167 |
| Capital contributions | 3,900,000 | 2,100,000 | 1,002,000 |
| Capital distributions | - | (3,500,000) | - |
| Net cash provided by (used in) financing activities | <u>18,116,891</u> | <u>(5,344,524)</u> | <u>24,986,348</u> |
| Net increase in cash | 723,917 | 281,200 | 1,579,284 |
| Cash and cash equivalents at beginning of year | 1,967,602 | 1,686,402 | 107,118 |
| Cash and cash equivalents at end of year | <u>\$ 2,691,519</u> | <u>\$ 1,967,602</u> | <u>\$ 1,686,402</u> |
| Supplemental Disclosure of Cash Flow Information | | | |
| Cash paid during the year for interest | <u>\$ 532,481</u> | <u>\$ 667,970</u> | <u>\$ 153,525</u> |
| Cash paid during the year for state income taxes | <u>\$ -</u> | <u>\$ 44,081</u> | <u>\$ -</u> |
| Supplemental Disclosure of Noncash Activities | | | |
| Equity converted to debt | <u>\$ 1,000,000</u> | <u>\$ -</u> | <u>\$ 695,000</u> |
| Investment in Thirteen Moons in accounts payable | <u>\$ -</u> | <u>\$ 200,000</u> | <u>\$ -</u> |
| Reclass of assets held for sale | <u>\$ 3,963,687</u> | <u>\$ -</u> | <u>\$ -</u> |

See accompanying notes to consolidated financial statements.

GRUENEPOINTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

A. Nature of Business

GruenePointe Holdings, LLC (a domestic limited liability company) (the “Company”) was established on April 21, 2014, in Dallas, Texas as a holding company for the development, construction, acquisition, and operation of healthcare facilities. The Company is comprised of the following consolidated subsidiaries, all of which are wholly-owned with the exception of Adora 9, LLC which is 84.8% owned.

Adora Entities

The Adora entities were established to develop, construct, and operate senior living communities, consisting of assisted living and skilled nursing facilities. The Company was actively developing three projects in Texas as of December 31, 2017.

- Adora Holdings, LLC
- Adora Holdings Development, LLC
- Adora 8, LLC
- Adora Creekside Realty, LLC
- Adora 9, LLC
- Adora 9 Realty, LLC
- Adora 9 Operations, LLC
- Adora 10, LLC

The Texas Ten Entities

The Texas Ten Entities (“Texas Ten”) were established to conduct the purchase and sale and leaseback and to facilitate the continuing operations of ten skilled nursing facilities with a total of 1,145 licensed beds. The facilities are located throughout Texas.

- GruenePointe 1 Graham, LLC
- GruenePointe 1 El Paso, LLC
- GruenePointe 1 Kerens, LLC
- GruenePointe 1 Casa Rio, LLC
- GruenePointe 1 River City, LLC
- GruenePointe 1 Brownwood, LLC
- GruenePointe 1 Longview, LLC
- GruenePointe 1 Kemp, LLC
- GruenePointe 1 Mt. Pleasant, LLC
- GruenePointe 1 Kaufman, LLC

Other Entities

GruenePointe 1 St. Giles, LLC operates a skilled nursing facility in Texas with a total of 124 licensed beds.

GRUENEPOINTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

A. Nature of Business – continued

Other Entities – continued

GruenePointe 1 Salvado, LLC was formed to maintain custody of reserve funds required by the Master Lease Agreement and Guaranty Agreement executed in conjunction with the sale and leaseback of the Texas Ten skilled nursing facilities.

GruenePointe Acquisition 1, LLC was formed to pursue the acquisition of the Texas Ten skilled nursing facilities. It later assigned its rights in transaction agreements to the Company.

Thirteen Moons, LLC is consolidated by the Company as a variable interest entity (“VIE”). See Note F for further discussion and Notes B and L for subsequent event related to the disposal of the related assets.

Going Concern

The Company has experienced significant recurring losses and has a net capital deficiency as of December 31, 2017. These factors raise substantial doubts about the Company’s ability to continue as a going concern. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the Company will need to manage cash flows and divest of certain operating assets. Additionally, if these actions don’t provide sufficient capital, the Company will have to obtain additional financing through debt or equity to fully implement its business plan, including continued growth.

The Company is currently in the final stages of negotiations with a member to sell the Texas Ten facilities, the St. Giles facility, and the GP Salvado entity to an affiliate of that member. Upon consummation of the sale, the Company will receive total consideration of \$4,000,000, including debt forgiven in the amount of \$673,378 and a promissory note in the amount of \$3,326,622. The promissory note will accrue interest at 6% annually and will have a five year term with a balloon payment due at maturity. The payment obligation is accelerated in the event that any of the underlying assets securing the note are sold or otherwise disposed of. Additionally, this transaction would eliminate a significant portion of the Company’s liabilities. The largest remaining liability is debt of approximately \$12.4 million and is due in November 2018, but contains two six month extensions at the option of the Company.

The remaining operations, after the consummation of the above sale, primarily include the Adora entities. Operations of the Adora entities will be funded by cash on hand, investor funds held in escrow which are expected to be released in the second quarter of 2018, and remaining availability to draw on the construction loan. Management of the Company believes it is probable that they will be able to execute their plans to divest of certain operational assets and to fund the operations of the Company for at least twelve months from the issuance of these consolidated financial statements. Ownership of the Company has the ability and wherewithal to provide capital as needed during this period if required.

Failure to execute the above strategy could have a material adverse effect on the Company’s business, financial condition, and results of operations. The consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

B. Summary of Significant Accounting Policies

A summary of the Company's significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

Basis of Accounting

The accounts are maintained and the consolidated financial statements have been prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP").

Principles of Consolidation

The consolidated financial statements include the Company's majority owned and controlled subsidiaries. VIE's have been consolidated as controlled subsidiaries when the Company is identified as the primary beneficiary. All intercompany transactions and balances have been eliminated through consolidation. For subsidiaries that are not wholly-owned by the Company, the portions not controlled by the Company are presented as noncontrolling interests in the consolidated financial statements.

Use of Estimates

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

Cash and Cash Equivalents

The Company considers all highly-liquid investments with a maturity of three months or less when purchased to be cash equivalents. At December 31, 2017 and 2016, the Company had no such investments. The Company maintains deposits in various financial institutions, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation ("FDIC"). The Company has not experienced any losses related to amounts in excess of FDIC limits.

Accounts Receivable

Accounts receivable are stated at amounts management expects to collect for providing patient care. Management provides for probable uncollectible amounts through a charge to bad debt expense and a credit to an allowance for doubtful accounts based on its assessment of the current status of individual accounts. Balances still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to patient accounts receivable.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

B. Summary of Significant Accounting Policies – continued

Accounts Receivable Reserve Methodology

The Company has implemented a standardized approach to estimate and review the collectability of its receivables based on accounts receivable aging trends. The Company analyzes historical collection trends and reimbursement experience by major payers, including Medicare, Medicaid, and other payers, as well as by business lines as an integral part of the estimation process related to determining the valuation allowance for accounts receivable. In addition, the Company assesses the current state of its billing functions on a quarterly basis in order to identify any known collection or reimbursement issues to determine the impact, if any, on its reserve estimates, which involve judgment. Revisions in reserve estimates are recorded as an adjustment to the provision for doubtful accounts, which is reflected in general and administrative expenses in the consolidated statements of operations beginning in 2016. In prior periods, adjustments were recorded against revenues.

Property, Equipment, and Leases

Property and equipment are stated at cost, and depreciation is computed using the straight-line method over the estimated useful lives of the assets (generally three to ten years). Maintenance and repairs of property and equipment are charged to operations when incurred. Gains or losses on the disposal of property and equipment are recognized in operations in the year of disposition.

The Company evaluates the recoverability of the carrying values of its properties and other long-lived assets on a property-by-property basis. The Company reviews its properties for recoverability when events or circumstances, including significant physical changes in a property, significant adverse changes in general economic conditions, and significant deteriorations of the underlying cash flows or fair value of a property, indicate that the carrying amount of the property may not be recoverable. The need to recognize an impairment is based on the estimated future undiscounted cash flows from a property compared to the carrying value of that property. If recognition of an impairment is necessary, it is measured as the amount by which the carrying amount of the property exceeds the fair value of the property.

Subsequent to the year ended December 31, 2017, the Company sold all assets related to the Thirteen Moons entity. The subsequent disposition meets the criteria for held for sale accounting at December 31, 2017. As such, the related assets have been separately stated on the consolidated balance sheet for the current period and were revalued at the lower of carrying value or fair value less costs to sale. As a result of revaluation, the Company recorded an impairment loss of \$164,867 and has been recorded in other income (expense) in the consolidated statement of operations.

Management did not identify any significant impairments during 2016. See Note D regarding 2015.

At the inception of each lease, the Company performs an evaluation to determine whether the lease should be classified as an operating or capital lease. The Company records rent expense for leases that contain scheduled rental escalations on a straight-line basis over the term of the lease. The lease term used for straight-line rent expense is calculated from the date the Company obtains control of the leased premises through the end of the lease term.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

B. Summary of Significant Accounting Policies – continued

License

Licenses are considered indefinite lived intangibles and are acquired in order to provide services to patients under care. On at least an annual basis the licenses are reviewed for impairment by first analyzing qualitative factors and, if necessary, assessing the intangible asset's fair value. No impairment charges were recorded in 2017, 2016, or 2015.

Deposits

Deposits consists of security deposits in the amount of two month's rent required by the Texas Ten facility lease, one month's rent required by the St. Giles lease, and various utility deposits.

Revenue Recognition and Patient Service Revenue

Revenues are derived from services rendered to patients for long-term care, including skilled and intermediate care, and rehabilitation services. Revenues are recorded when services are provided based upon established rates adjusted for amounts expected to be received under third-party contractual arrangements with governmental providers, Medicare, and Medicaid. These revenues and receivables are stated at amounts estimated by management to be at their net realizable value.

For private pay in long-term care, the facilities bill in advance for the following month, with the remittance being due upon receipt of the statement and generally by the 10th day of the month the services are performed. Private pay revenues billed in advance are deferred and recognized as services are rendered.

Payments are received from the Medicare program under a prospective payment system ("PPS"). For skilled nursing services, Medicare pays a fixed fee per Medicare patient day, based on the acuity level of the patient. Medicare program payments for long-term care services are based upon fixed per diem rates negotiated with a managed care organization contracted by the applicable state. The Medicaid program is jointly funded by the federal government and states. The federal government pays states for a specific percentage of program expenditures, called Federal Medical Assistance Percentages ("FMAP"). FMAP varies by state based on criteria such as per capita income. FMAPs are adjusted for each state on a three-year cycle to account for fluctuations in the economy. The FMAP is published annually in the Federal Register.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Noncompliance with such laws and regulations can be subject to regulatory actions including fines, penalties, and exclusion from the Medicare and Medicaid programs. Management believes the facilities are in material compliance with all applicable laws and regulations.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

B. Summary of Significant Accounting Policies – continued

Revenue Recognition and Patient Service Revenue – continued

The Medicare PPS methodology requires that patients be assigned to Resource Utilization Groups (“RUG”) based on the acuity level of the patient to determine the amount paid for patient services. The assignment on patients to the various RUG categories is subject to post-payment review by Medicare intermediaries. Management believes the Company has made adequate provision for any adjustments that may result from these reviews. Any differences between the net revenues and the final determination will be adjusted in future periods as adjustment become known.

Concentrations of Credit Risk

The Company grants credit without collateral to its residents, of whom most are insured under governmental programs or third party contractual agreements. The collectability or reliability of the accounts receivable is dependent primarily upon the performance of the government unit, the third party, or the resident’s family. Management does not believe significant credit risks are associated with accounts receivable.

Capitalization of Pre-Construction Costs

The Company capitalizes pre-construction costs until the project is placed in-service, at which time the asset is depreciated over its useful life.

Income Taxes

The members have elected to be taxed under sections of the federal and state income tax laws which provide that, in lieu of income taxes, the members separately account for their pro rata shares of the Company’s items of income, deductions, losses, and credits. Therefore, these statements do not include any provision for income taxes.

The Company classifies any interest recognized on an underpayment of income taxes as interest expense and classifies any statutory penalties recognized on a tax position taken as general and administrative expense. Management of the Company believes that they have not taken a tax position that, if challenged, would be expected to have a material effect on the consolidated financial statements in 2017, 2016, or 2015.

The Company files income tax returns in the United States federal jurisdiction and various state jurisdictions within the United States.

GRUENEPONTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

B. Summary of Significant Accounting Policies – continued

Fair Value of Financial Instruments

The Company calculates the fair value of its assets and liabilities, which qualify as financial instruments and includes this information in the notes to consolidated financial statements when the fair value is different than the carrying value of those financial instruments. The estimated fair value of patient accounts receivable, prepaid expenses and other current assets, accounts payable, related party payables, accrued expenses, and other accrued liabilities approximate the carrying amounts due to the relatively short maturity of these instruments. The carrying value of the notes payable and receivables financing also approximates fair value since these instruments bear market rates of interest. None of these instruments are held for trading purposes.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations.

C. Assets Limited as to Use

Assets limited as to use consist of designated working capital reserves and replacement reserves as required by the Master Lease Agreement and Guaranty Agreement, respectively, executed in conjunction with the sale and leaseback of the Texas Ten nursing facilities. The reserve funds are held in liquid savings account owned by GruenePointe 1 Salvado, LLC, whose sole purpose is to maintain the required reserves.

The working capital reserve was established as a liquid working capital reserve fund for operation of the facilities and any withdrawal requires consent of the landlord.

In lieu of additional financing on other projects, the landlord approved the withdrawal of the working capital reserve funds. These funds were used for construction costs on certain Adora projects.

The replacement reserve fund calls for an amount of \$500 per bed to be used for capital improvements throughout the life of the lease. As of December 31, 2017 and 2016, the total replacement reserve required is \$569,000 and \$572,500, respectively. The assets limited to use balance of \$469,765 is below the required reserve as of December 31, 2017. The Company received temporary relief for this shortfall as of December 31, 2017.

D. Pre-construction Costs

The Company is currently developing skilled nursing and assisted living facilities in Texas. These pre-construction amounts are classed into three specific projects: Adora 8 (Creekside); Adora 9 (Midtown); and Adora 14 (Austin). Funding sources for these projects are based on the approximate ratio of 10% equity financing, 65% conventional debt financing, and 25% mezzanine debt financing.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

D. Pre-construction Costs – continued

Below is a breakdown of the accumulated construction costs and projected project total cost as of December 31:

| Pre-Construction Costs: | Adora 8 | Adora 14 | Total Cost |
|--------------------------------------|--------------------|--------------------|---------------------|
| | (Creekside) | (Austin) | |
| 2017 | | | |
| Architecture fees | \$ 603,349 | \$ 356,293 | \$ 959,642 |
| Developer fees | 132,901 | 17,800 | 150,701 |
| Due diligence | 105,770 | - | 105,770 |
| Financing costs | 13,721 | - | 13,721 |
| Land acquisition | 808,423 | 2,101,800 | 2,910,223 |
| Property tax | 44,416 | 46,857 | 91,273 |
| Land use/planning | 8,982 | 6,880 | 15,862 |
| Insurance | 989 | 1,700 | 2,689 |
| Legal fees | 30,778 | 18,173 | 48,951 |
| Testing and inspections | - | 6,518 | 6,518 |
| Permits | 35,794 | 171,384 | 207,178 |
| Permit expediter | - | 488 | 488 |
| Third party architect | - | 27,986 | 27,986 |
| Medicaid bed waiver | - | 1,204,226 | 1,204,226 |
| Other | 3,441 | 3,582 | 7,023 |
| Total development costs | <u>1,788,564</u> | <u>3,963,687</u> | <u>5,752,251</u> |
| Transfer to construction in progress | <u>(808,423)</u> | <u>(3,306,026)</u> | <u>(4,114,449)</u> |
| | <u>\$ 980,141</u> | <u>\$ 657,661</u> | <u>\$ 1,637,802</u> |

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

D. Pre-construction Costs – continued

| Pre-Construction Costs: | Adora 8 | Adora 9 | Adora 14 | Total Cost |
|--------------------------------------|----------------------|----------------------|----------------------|----------------------|
| | <u>(Creekside)</u> | <u>(Midtown)</u> | <u>(Austin)</u> | |
| 2016 | | | | |
| Architecture fees | \$ 603,349 | \$ 705,481 | \$ 355,962 | \$ 1,664,792 |
| Developer fees | 132,901 | 658,736 | 17,800 | 809,437 |
| Due diligence | 93,770 | 17,795 | - | 111,565 |
| Financing costs | 13,721 | 33,060 | - | 46,781 |
| Land acquisition | 808,423 | 1,786,356 | 2,101,800 | 4,696,579 |
| Property tax | 22,208 | 92,175 | 46,857 | 161,240 |
| Land use/planning | 8,982 | - | 3,810 | 12,792 |
| Insurance | 989 | 989 | 1,700 | 3,678 |
| Legal fees | 30,778 | 300,658 | 18,173 | 349,609 |
| Testing and inspections | - | 40,861 | 6,518 | 47,379 |
| Permits | 35,794 | 35,043 | 171,384 | 242,221 |
| Permit expediter | - | 6,689 | - | 6,689 |
| EB-5 offering expense | - | 75,000 | - | 75,000 |
| Utilities | - | 8,643 | - | 8,643 |
| Third party architect | - | 19,048 | 27,986 | 47,034 |
| Green consultant | - | 2,925 | - | 2,925 |
| Origination and mortgage broker | - | 578,725 | - | 578,725 |
| Title policy | - | 108,902 | - | 108,902 |
| Medicaid bed waiver | - | — | 1,204,226 | 1,204,226 |
| Equity placement fee | - | 50,000 | - | 50,000 |
| Other | 3,441 | 12,458 | 2,187 | 18,086 |
| Total development costs | <u>1,754,356</u> | <u>4,533,544</u> | <u>3,958,403</u> | <u>10,246,303</u> |
| Transfer to construction in progress | <u>—</u> | <u>(4,533,544)</u> | <u>-</u> | <u>(4,533,544)</u> |
| | | \$ | | |
| | <u>\$ 1,754,356</u> | <u>-</u> | <u>\$ 3,958,403</u> | <u>\$ 5,712,759</u> |
| Projected project cost | <u>\$ 19,861,697</u> | <u>\$ 23,758,761</u> | <u>\$ 21,427,213</u> | <u>\$ 65,047,671</u> |

During the year ended December 31, 2015, the Company abandoned the Adora 10 (Hurst) project. The Company had incurred \$396,858 in land acquisition and development charges, which was expensed when management deemed the project not viable. This amount is recorded in the statements of operations under other expenses for the year ended December 31, 2015.

The Company began construction on the Adora 9 (Midtown) project in Dallas County, Texas in February 2016. Construction was complete and placed into service on December 27, 2017. The Company is currently in the design phase and is expected to commence construction in 2018 on Adora 8 (Creekside). Adora 14 (Austin) was subsequently sold in January 2018. See Note B and L for further disclosure.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

E. Receivables Financing

The Company has a financing agreement with a third-party lender. The lender has agreed to provide financing on a percentage of eligible patients accounts receivable with a maximum aggregate borrowing of \$17,000,000.

In accordance with the financing arrangement, the lender advances funds to the Company based upon receivable balances and reduces accumulated advances upon collection of the account. Interest is computed monthly based on a 5.61% annual rate at December 31, 2017. Also, a collateral fee of 1.2% is assessed based upon the month's average balance outstanding, as well as an unused commitment fee of 0.5%. The debt is secured by the eligible receivables and partially secured by the personal guarantees of certain members of the Company. The debt matures in April 2019.

The outstanding gross balances as of December 31, 2017 and 2016, were \$6,597,826 and \$4,811,441, respectively. The Company has recorded deferred financing costs of \$45,236 and \$180,944 at December 31, 2017 and 2016, respectively as prepaid expense and other current assets. Since the financing is considered similar to a line-of-credit these costs have not been netted against the balance on the consolidated balance sheets.

F. Variable Interest Entity

A wholly-owned subsidiary of the Company (Adora Holdings, LLC), purchased a 49% interest in Thirteen Moons, LLC from a related entity for \$3,700,000 on July 14, 2016. A payment of \$3,500,000 was paid at closing with the remaining \$200,000 due once certain conditions are met. Thirteen

Moons, LLC owns an underserved minority waiver granted by the Texas Department of Aging and Disability Services, as well as multiple parcels of land in Travis County, Texas. The plan is to build a skilled nursing facility on this land. The \$200,000 is recorded within accounts payable on the consolidated balance sheets. The remaining 51% of Thirteen Moons, LLC is due upon completion of the project. Adora Holdings, LLC is responsible for all construction related costs.

The Company determined that the entity is a VIE whereby the Company is the primary beneficiary and obligor. As such the entity has been consolidated in the 2017 and 2016 consolidated financial statements resulting in the consolidation of land of \$2,101,000, license of \$1,204,226 and various pre-construction costs of \$394,774. There is no significant impact on the consolidated statements of operations from consolidating the entity. As discussed in Note B above, all assets of Thirteen Moons, LLC were subsequently sold in 2018. As a result the land, license, and various pre-construction costs have been classified as held for sale on the consolidated balance sheet as of December 31, 2017.

G. Note Payable

The Company entered into a loan and security agreement with an unrelated third party in 2015. Interest accrued at 12% on the outstanding balance, with the first payment due February 2016. All outstanding principal and interest was paid in full in August 2016.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

G. Note Payable – continued

The Company converted an investor's capital account into a secured note payable on January 1, 2017. Interest accrues at 18% on the outstanding balance. The balance of this note was \$1,000,000 December 31, 2017. The maturity date for the note payable relates to the date on which a qualifying capital event is consummated. Due to the lack of a definitive maturity date, the Company has recorded the note payable as current.

The Company entered into a loan agreement with an unrelated third party in 2016 to assist in the funding of the Adora 9 Midtown construction project. Interest accrues at 13% on the outstanding balance. The balance of this note was \$12,430,506 and \$1,000 at December 31, 2017 and 2016, respectively, which includes \$267,561 and \$0, respectively, of accrued interest expense. The maturity date of the loan agreement is November 2018, but allows for two six-month extension options at the behest of the Company.

H. Related Party Accounts

The members have loaned funds to the Company during the course of operations. Some of these funds were originally classified as equity investments, but were reclassified to debt during 2015. These funds accrue interest at 12%, in accordance with the operating agreement. The Company intends to pay principal and accrued interest when funds become available. The total amounts due to members were \$1,075,000 and \$1,075,000 as of December 31, 2017 and 2016, respectively.

The Company is related through common ownership to the management company of its subsidiaries, OnPointe Management, LLC. Various transactions are entered into in the normal course of business between the common entities. Related party payables of \$282,016 and \$926,590 have resulted from these transactions as of December 31, 2017 and 2016, respectively, and are carried on the consolidated balance sheets at their original value and are included in the related party accounts. These payables are expected to be paid as cash becomes available in the common entities.

Unpaid management fees to OnPointe Management, LLC totaled \$3,827,847 and \$822,126 as of December 31, 2017 and 2016, respectively, and are included in related party payables on the accompanying consolidated balance sheets. See Note J for further discussion relating to the management agreement.

I. Major Customers

The facility's patient service revenues are derived primarily from federal (Medicare) and state (Medicaid) programs.

GRUENEPOINTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

I. Major Customers – continued

Below is a summary of the composition of revenues and accounts receivable as of December 31:

| | 2017 | | 2016 | | 2015 | |
|--------------|----------------|--------------------------------|----------------|--------------------------------|----------------|--------------------------------|
| | <u>Revenue</u> | <u>Accounts Receivable</u> | <u>Revenue</u> | <u>Accounts Receivable</u> | <u>Revenue</u> | <u>Accounts Receivable</u> |
| Medicaid | 47.48% | 34.39% | 47.45% | 31.79% | 48.44% | 47.31% |
| Medicare | 30.61% | 16.23% | 34.00% | 18.14% | 28.48% | 28.98% |
| Managed Care | 11.01% | 17.82% | 6.26% | 18.05% | 8.35% | 16.26% |
| Other | 10.90% | 31.56% | 12.29% | 32.02% | 14.73% | 7.45% |
| | <u>100.00%</u> | <u>100.00%</u> | <u>100.00%</u> | <u>100.00%</u> | <u>100.00%</u> | <u>100.00%</u> |

J. Management Agreements

The Company’s wholly-owned consolidated skilled nursing home subsidiaries are managed by OnPointe Management, LLC, a company related through common ownership. Management fees are accrued on 5% of net revenues of the nursing homes’ operations; however, the Company only pays 3% until certain operational metrics are achieved in accordance with the Master Lease Agreement. For 2017, 2016, and 2015, management fees were \$3,712,323, \$4,163,582, and \$1,724,792, respectively.

K. Commitments and Contingencies

The Company entered into a purchase and sale agreement and a Master Lease Agreement on July 29, 2015, whereby the Company bought, sold, and leased back ten skilled nursing facilities (“Texas Ten”). The initial term of the lease is fifteen years, with two additional renewal periods of five years each.

The Master Lease Agreement includes a provision for the payment of additional rents from the facilities owned by GruenePointe 1 Brownwood, LLC; GruenePointe 1 Graham, LLC; GruenePointe 1 Kerens, LLC; and GruenePointe 1 River City, LLC. The contingent rent totals 20% of year-to-year growth in net patient service revenue, if any, until the facility achieves certain yield benchmarks. Potential additional rent payments begin in the second lease year and continue throughout the lease term and are subject to a maximum limit.

The Company entered into a lease agreement with St. Giles Realty Holdings, LLC to lease the GruenePointe 1 St. Giles, LLC nursing facility. The lease has an initial term of ten years, with two additional renewal periods of five years each.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

K. Commitments and Contingencies – continued

Combined future lease commitments are as follows:

| | |
|------------|----------------------|
| 2018 | \$ 14,490,804 |
| 2019 | 14,780,620 |
| 2020 | 15,076,232 |
| 2021 | 15,377,757 |
| 2022 | 15,685,312 |
| Thereafter | <u>120,133,627</u> |
| | <u>\$195,544,352</u> |

The Texas Ten purchase and sale agreement resulted in a \$13,673,167 gain which will be recognized over the initial lease term of fifteen years. A portion of the gain (\$12,000,000) is contingent upon the Company achieving certain financial benchmarks during the first four years of the lease. The recognized gain for the years ended December 31, 2017, 2016, and 2015, was \$111,544, \$111,544, and \$46,477, respectively, and is a reduction of lease expense.

The components of lease expense as of December 31, are as follows:

| | <u>2017</u> | <u>2016</u> | <u>2015</u> |
|-----------------------------------|---------------------|---------------------|---------------------|
| Cash payments of lease | \$14,206,671 | \$13,928,109 | \$ 5,785,888 |
| Deferred lease liability | 1,632,072 | 1,910,634 | 844,059 |
| Recognized gain on sale/leaseback | <u>(111,544)</u> | <u>(111,544)</u> | <u>(46,477)</u> |
| | <u>\$15,727,199</u> | <u>\$15,727,199</u> | <u>\$ 6,583,470</u> |

The Company, certain members, and OnPointe Management, LLC, a related party, are jointly and severally liable for repayment of the contingent purchase price of \$12,000,000 under the purchase and sale agreement and obligations under the Master Lease Agreement above. The contingency will reduce in amount by \$3 million each January 1, beginning January 2016 through 2019, if the Company achieves certain financial benchmarks. Certain members are jointly and severally liable for an amount not to exceed \$6,000,000 in the aggregate. OnPointe Management, LLC is jointly and severally liable up to any management fees paid to them in the previous months.

In October 2015 the Company filed suit against one of its former managers asserting breach of contract, breach of fiduciary duty, willful misconduct, and negligence related to unauthorized transfers of funds. In February 2016 the Company received restitution of \$695,094 (the total of the unauthorized transfers) from the former manager. In May 2016 the suit was withdrawn without prejudice by the Company.

GRUENEPORTE HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

K. Commitments and Contingencies – continued

In June 2016 the same former manager filed suit against the Company alleging breach of fiduciary duty related to fees disputed by the Company. This suit is pending. Management does not believe the ultimate disposition of this matter will result in a material adverse effect on the financial position or results of operations of the Company.

Health Care Industry and Legal Considerations

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, quality of resident care, and Medicare and Medicaid fraud and abuse. Over the last several years, government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of fraud and abuse statutes and regulations as well as laws and regulations governing quality of care issues in the skilled nursing profession in general. Violations of these laws and regulations could result in exclusion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with such laws and regulations is subject to ongoing government review and interpretation, as well as regulatory actions which may be unknown or unasserted at this time. The Company is involved in regulatory actions of this type from time to time. Management is not aware of any regulatory actions that could have a material adverse impact on the Company.

L. Subsequent Events

In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through March 30, 2018, the date the consolidated financial statements were available to be issued.

In January 2018, the Company sold all assets related to the Thirteen Moons entity. The subsequent disposition meets the criteria for held for sale accounting at December 31, 2017. As such, the related assets have been separately stated on the consolidated balance sheet as of December 31, 2017, and were revalued at the lower of carrying value or fair value less costs to sale. As a result of revaluation, the Company recorded an impairment loss of \$164,867.