

APPENDIX C**CLASSIC RESIDENCE BY HYATT IN PALO ALTO****SCHEDULE OF FEES FOR OPTIONAL SERVICES**

(Effective 3/1/05)

The fees listed below represent the current fees for these services as of March 1, 2005. The Provider may change these fees upon 30 days' advance written notice.

Meals/Snacks**Additional Resident meals:**

à la carte Continental Breakfast (available only at The Bistro)	Priced per item	
Lunch at The Bistro	Priced per item	
	<u>at The Colonnade</u>	<u>at The Club Room</u>
Lunch	N/A	\$12 per meal
Dinner	\$20 per meal	\$20 per meal
Brunch / Holiday	\$22 per meal	\$22 per meal

Special diets prescribed by physician	Determined case by case
Nutritional supplements	Priced per item
In-home meal delivery	\$5 per meal
Snacks	Priced per item

Guest meals:

à la carte Continental Breakfast (available only at The Bistro)	Priced per item	
Lunch at The Bistro	Priced per item	
	<u>at The Colonnade</u>	<u>at The Club Room</u>
Lunch	N/A	\$14 per meal
Dinner	\$25 per meal	\$25 per meal
Brunch / Holiday	\$28 per meal	\$28 per meal

Guest Services

Guest room	\$120 per night
Roll-away bed (in guest room or resident's Home)	\$15 per night

Housekeeping/Engineering

Additional housekeeping services	\$24 per hour
Heavy housekeeping services	\$36 per hour
Additional engineering/maintenance services	\$48 per hour
Additional laundry services (during your scheduled housekeeping service)	\$5 per pound

Transfer

Transfer to a different independent living Home by personal preference	\$2,000 per move
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Transportation

Scheduled transportation if trip is outside scheduled route:

8:30 a.m. to 4:00 p.m. Monday through Friday	\$24 per hour
All other times	\$36 per hour
Cancellation fee	\$15

Miscellaneous

Returned check fee	\$35 per check
Mailbox key replacement fee	\$5 per key
Door lock replacement	\$50 plus labor and materials
Key card replacement fee	\$16 per card

APPENDIX D

CLASSIC RESIDENCE BY HYATT IN PALO ALTO

MONTHLY FEE CALCULATION COMMUNITY OPERATING COSTS

When the Community is opened for operations, the Provider will be responsible for all costs of operating the Community in excess of the Monthly Fees collected from residents (excluding and distinguished from Entrance Fees, payments for upgrades and one time payments for an additional parking space) prior to and including the Initial Minimum Occupancy Level Date (as defined in Section 3.3.2 (*Calculation of Monthly Fees*)). More specifically, the Provider will fund any deficit between Monthly Fees collected and the costs of operating the Community, including without limitation the funding of operating and capital reserves and a pro rata share of all expenses (e.g., taxes, insurance and Base Rent under the Ground Lease) that may accrue during or be allocable to the period prior to and including the Initial Minimum Occupancy Level Date, regardless of when such payments are actually made. After the Initial Minimum Occupancy Level Date, residents' Monthly Fees, when combined with other sources of revenue, but excluding Entrance Fees, payments for upgrades and one time payments for an additional parking space, are intended to pay all costs of operating the Community determined on a long-term, stabilized basis. Provider believes that at the time of achieving that occupancy, the Community is no longer in the startup mode. However, there is no assurance or guarantee that after the Initial Minimum Occupancy Level Date the sum of Residents' Monthly Fees will equal or exceed the costs of operating the Community.

After the Initial Minimum Occupancy Level Date, any deficit remaining at the end of a fiscal year (after first applying any previously established reserves therefor) between Monthly Fees collected from residents during that fiscal year and the costs of operating the Community during that fiscal year will be funded by a loan (the "Shortfall Loan") to the residents from the Provider. Each Shortfall Loan shall be repaid by residents over ten (10) years, commencing with the first month of the fiscal year immediately following the fiscal year in which the shortfall occurred, and will begin accruing interest on the first day of that month. Such interest will be

established for the year of funding at the prime lending rate as of the beginning of the fiscal year (as published in the Wall Street Journal) plus one percent (1%), compounded annually, and will be reset to the prime lending rate plus one percent (1%) as of the beginning of the fiscal year for each subsequent year. The Provider will provide residents with notice of the loan amount(s) and the repayments required. A Shortfall Loan will be a binding obligation of the residents when made, but will not be evidenced by an executed promissory note. The amount, interest rate, loan term, and other terms of the loan shall be as evidenced in and in accordance with the books and records of the Provider.

If the Community generates revenues (excluding Entrance Fees, payments for upgrades and one time payments for an additional parking space) in excess of its operating costs for a fiscal year, such surplus will be applied as a prepayment of outstanding principal under any Shortfall Loan(s). Such prepayment will not change the minimum payments that are due under the ten-year repayment schedule of any Shortfall Loan. If an operating surplus is generated prior to the Initial Minimum Occupancy Level Date, such surplus will be retained by the Provider. If an operating surplus is generated after the Initial Minimum Occupancy Level Date, but there is not a Shortfall Loan to be repaid, such surplus will be retained by the Community and may be used at the discretion of the Provider as a reserve to cover operating deficits or to lower future monthly fees (or some combination thereof).

The operational costs intended to be paid from residents' Monthly Fees include, but are not limited to: (i) the costs to provide all services and amenities under this Contract and under all other resident contracts at the Community; (ii) the costs of insurance policies, including property, casualty and liability insurance policies; (iii) employee expenses; (iv) all costs of maintenance, repairs, and replacements of capital items, including furnishings, fixtures and equipment; (v) operating and capital reserves; (vi) a management fee to Classic Residence or its successor; (vii) Base Rent payments under the Ground Lease for the Community; and (viii) any marketing costs incurred after the later to occur of either (a) the Initial Minimum Occupancy Level Date; or (b) the end of the month in which ninety percent (90%) of the independent living units are subject to a residency contract or reserved with each reservation having a deposit of at least twenty percent (20%) of the then applicable unit Entrance Fee, or both.

Costs of operating the Community include costs of a capital nature that arise after the initial construction and furnishing of the Community is completed. These latter costs are to be paid out of a Capital Item Replacement Reserve that shall be established through an allocation of

a percentage of Monthly Fees charged to residents, which currently shall be 5% of Monthly Fee revenue annually. The Capital Item Replacement Reserve will be held at the Community level and will be invested in government securities or other conservative investment vehicles. No debt service of any kind will be included in the Monthly Fees, except for Shortfall Loans, if any, as described in this **Appendix D**.

The Provider will forecast, on an annual basis, anticipated costs of operating the Community and anticipated Monthly Fee revenue for the next year and for future years. Typically, the forecasting occurs in October and the Provider establishes Monthly Fees on or before January 1st of each year for such year.

APPENDIX E

CLASSIC RESIDENCE BY HYATT IN PALO ALTO

HISTORIC SCHEDULE OF AVERAGE MONTHLY FEES

HOME TYPE	2005	2006	2007	2008	2009
ONE BEDROOM					
TWO BEDROOM					

APPENDIX F

CLASSIC RESIDENCE BY HYATT IN PALO ALTO

ASSISTED LIVING AND MEMORY SUPPORT SERVICES

ASSISTED LIVING PROGRAM

The Provider will furnish assisted living services, as needed, for residents who require assistance with activities of daily living. The assisted living services will be provided in the Assisted Living Center. The level of assisted living services that You shall receive will depend on the frequency and intensity of Your care needs and the type of personal care services You require.

In addition to the services described in Sections 1 and 2 of this Contract, You may receive one or more of the following services in the Assisted Living Center, as needed:

1. Assistance with showering or bathing, daily dressing, grooming and other personal hygiene activities.
2. Limited incontinence care
3. Assistance with dining, including monitoring and supervision at meal and snack times
4. Walk-along assistance to meals
5. Food tray deliveries, as needed, during a temporary illness
6. Assistance with self-administration of medications, including orders, central storage, and scheduling and distribution of medications
7. Assistance with toilet activities, as needed
8. Supervised assistance with ambulation
9. Nursing interventions and care, including monitoring, assessment, treatments, evaluation and supervision.
10. Monitoring of Your health status
11. Temporary illness or post hospitalization monitoring
12. Nutritional supervision

13. Weekly clinic programs, offering blood pressure, vital signs measurements and weight checks.
14. Daily tidying of Your Home or assisted living apartment, including trash removal
15. Daily bedmaking.
16. Mail delivery to Your Home or assisted living apartment
17. Escort to recreational, social, or religious activities provided on-site
18. Assistance with accessing higher levels of care as needed and prescribed by Your primary care physician and the Provider's care team.

MEMORY SUPPORT PROGRAM

The Provider's Memory Support Program is designed for residents with mild dementia or cognitive impairment who may benefit from additional structure and supervision and residents who require special care for moderate to severe Alzheimer's disease or another dementia. This program is provided at the Memory Support Center.

Mild Forms of Dementia

For residents with mild dementia or cognitive impairment, the Memory Support Program supplements the Assisted Living Program, as appropriate, with the following services, as needed:

1. Assisted living services described under the Assisted Living Program
2. Activity programs adapted for persons with cognitive impairment.

Moderate to Severe Dementia

For residents who require special care for moderate to severe Alzheimer's disease or related dementias, the Program supplements the Assisted Living Program, as appropriate, with the following services, as needed:

1. Assisted living services described under the Assisted Living Program
2. Wandering bracelet
3. A secure environment
4. A nutritious snack program
5. An activity program specially designed for moderate to severely demented residents.
6. A specially designed secured outdoor activity area
7. Staff specially trained in the care of residents with dementias and related illnesses.

APPENDIX G

CLASSIC RESIDENCE BY HYATT IN PALO ALTO

REPAYMENT AMOUNT AND IMPUTED INTEREST CALCULATION

A. Repayment Amount Calculation

You have selected the Entrance Fee repayment program that establishes ninety percent (90%) as the "Minimum Repayment Percentage" to be used when calculating any Repayment Amount due to You under this Contract.

The "Amortization Rate" to be used when calculating any Repayment Amount due to You is two percent (2%) for each "Month" after the Occupancy Date, as defined in Section 3.3.1 (*Monthly Fee: Amount to Pay*). To calculate the number of "Months" that have passed since the Occupancy Date, Provider will divide the total number of days from the Occupancy Date through the effective termination date by thirty (30), and any remaining days will be considered an additional "Month."

Your Repayment Amount will be (a) the greater of (i) the amount of Your Entrance Fee Note times the Minimum Repayment Percentage, and (ii) the amount of Your Entrance Fee Note minus the product of the Entrance Fee Note and the Amortization Rate for each Month from the Occupancy Date; minus (b) all outstanding Monthly Fees, Miscellaneous Expenses, Deferred Charges and other charges owing to Provider.

Examples [assuming a 90% Minimum Repayment Percentage and a 2% Amortization Rate]:

1. Resident pays \$500,000 Entrance Fee. Resident terminates the Contract 107 days after the Occupancy Date (i.e., 4 "Months" for purposes of the Repayment Amount under this Contract), owing \$2,000 in unpaid Miscellaneous Expenses:

The Repayment Amount is \$458,000: \$460,000 (\$500,000 reduced by 2% times 4 Months) minus \$2,000.

2. Resident pays \$600,000 Entrance Fee. After 360 days from the Occupancy Date Resident moves to a \$500,000 unit (collecting an Entrance Fee Note prepayment), then terminates 300 days later:

The Repayment Amount is \$450,000: \$500,000 (the amount of the Entrance Fee Note based upon the Entrance Fee for the new Unit (see Section 7.4)) times the 90% Minimum Repayment Percentage.

B. Imputed Interest Calculation

Subject to Section 10.8 of this Contract, You will receive from Provider on the Interest Payment Date (as defined below) in each calendar year, commencing in the calendar year following Your initial occupancy of Your Home and continuing until the Interest Payment Date of the calendar year following the expiration or termination of this Contract, an interest payment for the prior calendar year (the "Prior Year") equal to the product of A times B times C, where: "A" is the excess of (i) Your Entrance Fee Note multiplied by the Minimum Repayment Percentage, over (ii) the exemption for the Prior Year as determined under Internal Revenue Code ("Code") Section 7872(g) or its successor provision; "B" is the average applicable federal rate ("AFR") during the Prior Year as determined under Code Section 7872(f)(2)(B) or its successor provision for "short-term" or "demand" loans; and "C" is the Tax Rate (as defined below) for the Prior Year, as confirmed in a certificate (the "Tax Rate Certificate") signed by You and addressed and delivered to Provider no later than October 15 of each year. For purposes hereof:

"Tax Rate" means the sum of the following two fractions expressed as a percentage: (x) Your California State income tax liability for the Prior Year divided by Your California adjusted gross income for the Prior Year, and (y) Your U.S. federal income tax liability for the Prior Year divided by Your U.S. federal adjusted gross income for the Prior Year; provided, however, that if You fail to deliver Your Tax Rate Certificate on or before October 15th of any year, then the Tax Rate for the Prior Year shall be twenty percent (20%), and for purposes of the Interest Payment Date

determination, You shall be deemed to have delivered the Tax Rate Certificate on October 15th of the calendar year after such Prior Year .

"Interest Payment Date" means April 15, if Your Tax Rate Certificate is delivered to Provider before April 1st of such year or, if Your Tax Rate Certificate is delivered to Provider after April 1st of such year, no later than fourteen days after such delivery.

The amount payable hereunder by Provider on any Interest Payment Date shall be reduced based on the number of days, if any, in the Prior Year that precede the execution or follow the termination of this Contract.

Provider reserves the right, from time to time, to verify Your Tax Rate for any year(s), and You shall furnish Your California and federal income tax returns to Provider for such year(s) as Provider may request. If You fail to furnish Your California and federal income tax returns for any year to Provider, the Tax Rate for such year shall be deemed to have been twenty percent (20%). If it is determined, pursuant to the preceding sentence or by an audit of Your returns, that You received any interest payment(s) greater than You were entitled to receive ("Excess Payment(s)"), You shall pay the amount of such Excess Payment(s) to Provider on demand and any such payments shall be deemed to have been due from the Interest Payment Date(s) until the date of Your repayment to Provider. Any amount You owe pursuant to the preceding sentence shall be deemed a Miscellaneous Expense.

EXAMPLE:

Assume the following:

1. Your average Repayment Amount for the year in question is \$900,000.
2. The average AFR for the year in question is 1.5%.
3. The exempt portion of the returnable entrance fee for the year in question under Section 7872 (g) of the Internal Revenue Code is \$160,000.
4. The Tax Rate is 35%.

The interest payment to be made to You by the Provider on or before the applicable Interest Payment Date of the year following is \$3,885 [i.e., $\$900,000 - \$160,000$) (.015) (.35). = \$3,885.00].

Since 1984, a moratorium has been in effect on the IRS's enforcement of the imputed interest rules with respect to below-market loans made to continuing care communities that are not "qualified continuing care facilities." The Provider reserves the right to change the structure of the Community by selling or transferring the Care Center assets, including the Skilled Nursing Facility, to an affiliated company and establishing a lease between the affiliate and the Provider. If the Provider enters into such a lease, the lease payments made by the Provider will not be deemed operational costs of the Community for purposes of computing fees to be charged to residents, whether through Monthly Fees or otherwise. If the Provider determines that, after such restructuring of the Community, the Community will no longer be a "qualified continuing care facility" and will be eligible for the moratorium applicable to non-qualified facilities, the Provider will not make any annual interest payments to You. If, after such a restructuring, the IRS adopts regulations that result in the application of the imputed interest rules to non-qualified continuing care communities, then, during the period of time that the Community is a non-qualified continuing care facility, the Provider will indemnify You from any income tax liability on interest income imputed to You and from any penalties assessed against You by the IRS or other taxing authority.

The Internal Revenue Code and Regulations may be amended from time to time and the Provider will not monitor or provide notices to You of any such amendments. You are urged to seek independent tax advice concerning any tax consequences associated with this Contract. In the event that the Internal Revenue Code or implementing regulations are amended so that there is no longer income tax expense associated with imputed interest income applicable to this Contract or the Entrance Fee, the Provider will no longer be obligated to make payments to You under Section 10.8. and the indemnification referred to in the preceding paragraph will no longer be available for periods of time after the amendment of the Internal Revenue Code or implementing regulations.

APPENDIX H

CLASSIC RESIDENCE BY HYATT IN PALO ALTO

NOTICE OF CANCELLATION

Your first date of occupancy under this Contract is: _____.
For purposes of this notice, the phrase "Your first date of occupancy" shall mean the
"Occupancy Commencement Date" as defined in Section 8.1 of this Contract.

You may cancel this transaction, without any penalty within ninety (90) calendar days
from the above date.

If You cancel, any property transferred, any payments made by You under this Contract,
and any negotiable instrument executed by You will be returned within fourteen (14)
calendar days after making possession of the living unit available to the Provider. Any
security interest arising out of the transaction will be cancelled.

If You cancel, You are obligated to pay a reasonable processing fee to cover costs and to
pay for the reasonable value of the services received by You from the Provider up to the
date You canceled or made available to the Provider the possession of any living unit
delivered to You under this Contract, whichever is later.

If You cancel, You must return possession of any living unit delivered to You under this
Contract to the Provider in substantially the same condition as when You took possession.

Possession of the living unit must be made available to the Provider within 20 calendar
days of Your notice of cancellation. If You fail to make the possession of any living unit
available to the Provider, then You remain liable for performance of all obligations under
this Contract.

To cancel this transaction, mail or deliver a signed and dated copy of this cancellation
notice, or any other written notice, or send a telegram to CC-Palo Alto, Inc., c/o Classic
Residence by Hyatt, 71 South Wacker Drive, Suite 900, Chicago, IL 60606, Attention:
General Counsel, no later than midnight of _____, _____.

I (we) hereby cancel this transaction.

(Date)

(Date)

(Resident or Transferor's Signature)

(Resident or Transferor's Signature)

NOTICE OF CANCELLATION

Your first date of occupancy under this Contract is: _____.
For purposes of this notice, the phrase "Your first date of occupancy" shall mean the "Occupancy Commencement Date" as defined in Section 8.1 of this Contract.

You may cancel this transaction, without any penalty within ninety (90) calendar days from the above date.

If You cancel, any property transferred, any payments made by You under this Contract, and any negotiable instrument executed by You will be returned within fourteen (14) calendar days after making possession of the living unit available to the Provider. Any security interest arising out of the transaction will be cancelled.

If You cancel, You are obligated to pay a reasonable processing fee to cover costs and to pay for the reasonable value of the services received by You from the Provider up to the date You canceled or made available to the Provider the possession of any living unit delivered to You under this Contract, whichever is later.

If You cancel, You must return possession of any living unit delivered to You under this Contract to the Provider in substantially the same condition as when You took possession.

Possession of the living unit must be made available to the Provider within 20 calendar days of Your notice of cancellation. If You fail to make the possession of any living unit available to the Provider, then You remain liable for performance of all obligations under this Contract.

To cancel this transaction, mail or deliver a signed and dated copy of this cancellation notice, or any other written notice, or send a telegram to CC-Palo Alto, Inc., c/o Classic Residence by Hyatt, 71 South Wacker Drive, Suite 900, Chicago, IL 60606, Attention: General Counsel, no later than midnight of _____.

I (we) hereby cancel this transaction.

(Date)

(Date)

(Resident or Transferor's Signature)

(Resident or Transferor's Signature)

APPENDIX I

CLASSIC RESIDENCE BY HYATT IN PALO ALTO

STATEMENT OF RESIDENTS' RIGHTS

I. Health and Safety Code Section 1771.7 grants the following rights to residents of continuing care retirement communities:

A. No resident of any continuing care retirement community shall be deprived of any civil or legal right, benefit, or privilege guaranteed by law, by the California Constitution, or by the United States Constitution solely by reason of status as a resident of a community. In addition, because of the discretely different character of residential living unit programs that are a part of continuing care retirement communities, this Section shall augment Chapter 3.9 (commencing with Section 1599), Section 73523 of Title 22 of the California Code of Regulations, and applicable federal law and regulations.

B. All residents in residential living units shall have all of the following rights:

- (1) To live in an attractive, safe and well maintained physical environment.
- (2) To live in an environment that enhances personal dignity, maintains independence and encourages self-determination.
- (3) To participate in activities that meet individual physical, intellectual, social and spiritual needs.
- (4) To expect effective channels of communication between residents and staff, and between residents and the administration or Provider's governing body.
- (5) To receive a clear and complete written contract that establishes the mutual rights and obligations of the resident and the continuing care retirement community.
- (6) To maintain and establish ties to the local community.
- (7) To organize and participate freely in the operation of resident associations.

II. RESIDENTIAL CARE FACILITY FOR THE ELDERLY LAW

Pursuant to Section 87572 of Title 22 of the California Code of Regulations, You shall have personal rights, which include, but are not limited to, the following:

1. To be accorded dignity in Your personal relationships with staff, residents and other persons.
2. To be accorded safe, healthful and comfortable accommodations, furnishings and equipment.
3. To be free from corporal or unusual punishment, humiliation, intimidation, mental abuse or other actions of a punitive nature, such as withholding of monetary allowances or interfering with daily living functions such as eating or sleeping patterns or elimination.
4. To be informed by the Provider of the provisions of law regarding complaints and of procedures to register complaints confidentially, including, but not limited to, the address and telephone number of the complaint receiving unit of the Department of Social Services.
5. To have the freedom of attending religious services or activities of Your choice and to have visits from the spiritual advisor of Your choice. (Attendance at religious services, in or outside the Community, shall be voluntary.)
6. To leave or depart the Community at any time and not to be locked in any room, building or premises at the Community by day or night. (This does not prohibit the establishment of rules applicable to the Community, such as the locking of doors at night, for the protection of residents; nor does it prohibit, with permission of the Department of Social Services, the barring of windows against intruders.)
7. To visit the Community prior to residence, along with Your family and responsible persons.
8. To have Your family or responsible persons regularly informed by the Provider of activities related to Your care or services, including ongoing evaluations, as appropriate to Your needs.
9. To have communications to the Provider from Your family and responsible persons answered promptly and appropriately.
10. To be informed of the Community's policy concerning family visits and other communications with residents as specified in Health and Safety Code Section 1569.313.

11. To have Your visitors, including ombudspersons and advocacy representatives, permitted to visit privately during reasonable hours and without prior notice, provided that the rights of other residents are not infringed upon.

12. To wear Your own clothes; to keep Your own personal possessions, including Your toilet articles; and to keep and be allowed to spend Your own money.

13. To have access to individual storage space for private use.

14. To have access to telephones in order to make and receive confidential calls. The Community may require reimbursement from You for long distance calls.

15. To mail and receive unopened correspondence in a prompt manner.

16. To receive or reject medical care or health-related services.

17. To receive assistance in exercising the right to vote.

18. To move from the Community.

The resident and the resident's legal representative, if applicable, is hereby informed of the appropriate licensing agency to contact regarding complaints:

Department of Social Services
Community Care Licensing Office
111 North Market Street, Suite 350
San Jose, CA 95113
Telephone: (408) 277-1289

By signing below, You acknowledge that You have received a copy of the personal rights delineated above and outlined in Title 22 of the California Code of Regulations at the time of Your admission:

Resident: _____ Date: _____

Resident's Representative: _____ Date: _____

APPENDIX J

CLASSIC RESIDENCE BY HYATT IN PALO ALTO

AUDITED FINANCIAL STATEMENT

CC-PALO ALTO, INC.

Financial Statements

December 31, 2003 and January 31, 2003

(With Independent Auditors' Report Thereon)

CC-PALO ALTO, INC.

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KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Board of Directors
CC-Palo Alto, Inc.:

We have audited the accompanying balance sheets of CC-Palo Alto, Inc. (the Company) as of December 31, 2003 and January 31, 2003 and the related statements of operations, changes in shareholder's equity, and cash flows for the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CC-Palo Alto, Inc. as of December 31, 2003 and January 31, 2003, and the results of its operations and its cash flows for the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

February 6, 2004



KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.



CC-PALO ALTO, INC.**Balance Sheets****December 31, 2003 and January 31, 2003**

Assets	December 31, 2003	January 31, 2003
Current assets:		
Cash and cash equivalents	\$ 5,316	2,431
Total current assets	5,316	2,431
Property and equipment:		
Construction in progress	44,784,612	11,275,531
Property and equipment, net of accumulated depreciation of \$38,998 and \$22,589, respectively	52,536	65,221
Total property and equipment	44,837,148	11,340,752
Other assets:		
Restricted escrow cash	74,812,213	68,355,419
Long-term receivable	783,572	744,030
Deferred compensation, net	139,182	190,220
Costs of acquiring initial continuing care contracts	4,199,695	2,526,145
Deferred financing fees, net	4,631,732	—
Prepaid marketing fees	3,694,892	—
Deposits	1,007,100	1,005,500
Total assets	\$ 134,110,850	84,164,497
Liabilities and Shareholder's Equity		
Current liabilities:		
Accounts payable	\$ 61,198	12,159
Construction costs payable	12,694,653	—
Accrued costs of acquiring initial continuing care contracts	26,580	1,167
Accrued expenses	122,880	64,270
Total current liabilities	12,905,311	77,596
Long-term debt	27,222,771	—
Noncurrent deferred tax liability, net	2,772,096	9,218
Escrow deposits	74,601,877	68,355,419
Total liabilities	117,502,055	68,442,233
Shareholder's equity:		
Common stock, no par value. Authorized, issued, and outstanding 100 shares	—	—
Additional paid-in capital	20,234,499	16,470,072
Accumulated deficit	(3,625,704)	(747,808)
Total shareholder's equity	16,608,795	15,722,264
Total liabilities and shareholder's equity	\$ 134,110,850	84,164,497

See accompanying notes to financial statements.

CC-PALO ALTO, INC.**Statements of Operations****Eleven-month period ended December 31, 2003 and year ended January 31, 2003**

	Eleven-month period ended December 31, 2003	Year ended January 31, 2003
Revenue:		
Interest income	\$ 1,354,729	52,777
Other income	15,770	88,549
	<u>1,370,499</u>	<u>141,326</u>
Expenses:		
Administrative	17,567	235,211
Marketing	354,235	334,225
Interest expense	1,096,506	—
Depreciation	16,409	14,200
	<u>(114,218)</u>	<u>(442,310)</u>
Loss before income tax benefit		
	(114,218)	(442,310)
Income tax benefit	33,928	154,808
	<u>33,928</u>	<u>154,808</u>
Net loss	<u>\$ (80,290)</u>	<u>(287,502)</u>

See accompanying notes to financial statements.

CC-PALO ALTO, INC.

Statements of Changes in Shareholder's Equity

Eleven-month period ended December 31, 2003 and year ended January 31, 2003

	Common stock		Additional paid-in capital	Accumulated deficit	Total
	Shares	Amount			
Balance at January 31, 2002	100	\$ —	—	(298,800)	(298,800)
Contribution from Parent	—	—	16,470,072	—	16,470,072
Tax adjustment	—	—	—	(161,506)	(161,506)
Net loss	—	—	—	(287,502)	(287,502)
Balance at January 31, 2003	100	—	16,470,072	(747,808)	15,722,264
Contribution from Parent	—	—	3,764,427	—	3,764,427
Tax adjustment	—	—	—	(2,797,606)	(2,797,606)
Net loss	—	—	—	(80,290)	(80,290)
Balance at December 31, 2003	100	\$ —	20,234,499	(3,625,704)	16,608,795

See accompanying notes to financial statements.

CC-PALO ALTO, INC.

Statements of Cash Flows

Eleven-month period ended December 31, 2003 and year ended January 31, 2003

	Eleven-month period ended December 31, 2003	Year ended January 31, 2003
Cash flows from operating activities:		
Net loss	\$ (80,290)	(287,502)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	16,409	14,200
Deferred tax liability	2,762,878	6,698
Tax adjustment	(2,797,606)	(161,506)
Interest accrued on escrow deposits	1,096,506	—
Changes in operating assets and liabilities:		
Deposits	(1,600)	—
Accounts payable	49,039	6,393
Accrued expenses	84,023	6,628
Net cash provided by (used in) operating activities	1,129,359	(415,089)
Cash flows from investing activities:		
Construction in progress, net of change in related construction costs payable	(20,042,473)	(7,977,622)
Purchase of property and equipment	(3,724)	(33,600)
Costs of acquiring initial continuing care contracts, net of change in related accrual	(1,622,512)	(1,292,632)
Repayment of long-term receivable, net of change in accrued interest and discount	(39,542)	(40,714)
Funding of prepaid marketing fees	(3,694,892)	—
Net cash used in investing activities	(25,403,143)	(9,344,568)
Cash flows from financing activities:		
Proceeds from long-term debt	27,222,771	—
Funding of restricted escrow cash	(6,456,794)	(66,610,589)
Increase in escrow deposits liability	5,149,952	66,610,589
Contribution from Parent	3,764,427	9,762,088
Payment of deferred financing costs	(5,403,687)	—
Net cash provided by financing activities	24,276,669	9,762,088
Net increase in cash and cash equivalents	2,885	2,431
Cash and cash equivalents, beginning of period	2,431	—
Cash and cash equivalents, end of period	\$ 5,316	2,431
Noncash investing activity:		
Deferred compensation capitalized to costs of acquiring continuing care contracts	\$ 51,038	55,682
Interest paid, net of amount capitalized	—	—
Noncash financing activity:		
Transfer of Due to Parent to additional paid-in capital	\$ —	6,707,984

See accompanying notes to financial statements.

CC-PALO ALTO, INC.

Notes to Financial Statements

December 31, 2003 and January 31, 2003

(1) Purpose and Organization

CC-Palo Alto, Inc. (the Company) is a wholly owned subsidiary of CC-Development Group, Inc. (the Parent). The Company, a Delaware corporation, was incorporated on June 23, 1999 for the purpose of developing, owning, and operating a 494-unit senior living community (the Community) in Palo Alto, California. Construction of the Community began in 2003 with operations expected to commence in 2005.

Effective February 1, 2003 the Company changed its fiscal year to end on December 31 rather than on January 31.

(2) Summary of Significant Accounting Principles

Use of Estimates in Preparation of Financial Statements

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

Cash and Cash Equivalents

The Company considers all investments purchased with a maturity of three months or less to be cash equivalents.

Property and Equipment

Property and equipment is stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. Construction in progress represents costs capitalized that were incurred to ready the Community for development. Interest related to long-term debt incurred during construction periods is capitalized and will be amortized on the same basis as the related constructed assets. For the eleven months ended December 31, 2003, the Company capitalized interest of \$245,766. No interest was capitalized for the year ended January 31, 2003. Real estate taxes paid during the construction period are capitalized to construction in progress. As of December 31, 2003, approximately \$37,000 of real estate taxes has been capitalized to construction in progress.

Impairment of Long-lived Assets

Long-lived assets, such as property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The Company does not believe that there are any factors or circumstances indicating impairment of its property and equipment as of December 31, 2003.

CC-PALO ALTO, INC.

Notes to Financial Statements

December 31, 2003 and January 31, 2003

Restricted Escrow Cash

Restricted cash consists of good faith deposits that are received by the Company upon the commitment of prospective residents to enter into a residency agreement. These funds are placed in an interest bearing escrow account, as required by the Department of Social Services of the State of California, and are available to the Company once certain conditions are met. Each escrow deposit earns interest based on the 30-day average treasury rate for the period beginning with the date of deposit and ending with the date the resident executes their residency agreement or when the deposit agreement is terminated under certain conditions. For the eleven months ended December 31, 2003, the Company had recorded \$1,096,506 of interest expense associated with these deposits.

Costs of Acquiring Initial Continuing Care Contracts

Costs of acquiring initial continuing care contracts (the Costs) consist principally of marketing and advertising costs incurred directly in relation to the initial acquisition of continuing care contracts. The Costs will be amortized using the straight-line method over a period of ten years, beginning in the first period in which revenues associated with the Costs are earned.

Deferred Charges

Deferred charges include financing costs paid to obtain construction financing (see note 3). The costs are being amortized over the life of the loan. Amortization was \$771,955 for the eleven months ended December 31, 2003 and was capitalized to construction in progress.

Income Taxes

Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred income taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of restricted cash held in escrow. The Company's restricted cash is held in a money market account with Union Bank of California. Management believes credit risk related to this restricted cash to be minimal.

Fair Value of Financial Instruments

Fair value is determined by using available market information and appropriate valuation methodologies. Due to their short maturities, the Company's financial instruments are carried at amounts that reasonably approximate fair value. At December 31, 2003, the carrying value of the long-term debt approximates its fair value, as the interest rate associated with the borrowing approximates current market rates.

CC-PALO ALTO, INC.**Notes to Financial Statements****December 31, 2003 and January 31, 2003****(3) Long-term Debt**

On July 2, 2003, the Company entered into an agreement with various banks to borrow up to \$300,000,000. The agreement provides for borrowings from time to time related to the construction of the Community through the maturity date of January 2, 2007. The construction loan requires interest payments at LIBOR plus 2.25% (3.37% at December 31, 2003) every thirty days on the outstanding loan amounts and is collateralized by the leasehold interest in the property, the building, furnishings, and equipment. The interest rate accrued on the construction debt is dependent upon the stage of construction and presales level and has a maximum rate of LIBOR plus 2.25% (3.37% at December 31, 2003). The agreement also requires quarterly commitment fees equal to .5% of the unused loan amount and letter of credit fees equal to the LIBOR margin (2.25% at December 31, 2003) applied against the \$6,000,000 face amount. The agreement contains quarterly covenants related to the number of presales and occupancy, with which the Company is in compliance as of December 31, 2003. As of December 31, 2003, the Company has an available amount to borrow for future construction of approximately \$266,777,000 under the construction loan. The Parent has provided limited guarantees of the Construction loan.

For the year ended December 31, 2003, the Company incurred interest on its long-term debt of \$245,766 and commitment fees of \$313,570, all of which has been capitalized to construction in progress.

(4) Ground Lease

On August 1, 2000, the Company entered into a 75-year ground lease agreement with Stanford University (Lessor). The lease calls for monthly payments of \$125,000 plus annual Consumer Price Index (CPI) increases. The monthly payments for the year ended December 31, 2003 totaled approximately \$739,000 (approximately \$132,000 per month) and is included in construction in progress. The lease payments began with the commencement of the construction of the Community in July 2003. In addition, participating rent of 6% of all gross receipts is payable monthly beginning with the initial occupancy, as defined. In February 2002, the Company paid a \$1,000,000 deposit as required by the ground lease agreement. After initial occupancy, the monthly payments are adjusted every 5 years to reflect increases in CPI; the maximum CPI increase is 7% for a 5-year period. It is anticipated that initial occupancy will be in 2005.

The ground lease also calls for the Company to loan the Lessor \$20,000,000 in the form of a promissory note (Note) upon initial occupancy. The Note is for a period of seventeen years and requires annual payments of principal and interest at a rate of 7.5% per annum. The Note is secured by the participating rent paid to the Lessor.

(5) Income Taxes

The operating results of the Company are included in the Parent's consolidated Federal income tax return. The Company is party to a tax-sharing agreement, which provides that, among other things, the Company shall not be entitled to any reimbursement for utilization of its tax attributes in the consolidated Federal income tax return of the Parent. The Company is required to pay the Parent for any tax liability that may arise from its operations, computed on a separate return basis. For the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003, the Company sustained losses for Federal income tax purposes. For the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003, the current Federal income tax benefit attributable to the Company in the Parent company's consolidated Federal income tax return, as required pursuant to the provision of SFAS No. 109,

CC-PALO ALTO, INC.

Notes to Financial Statements

December 31, 2003 and January 31, 2003

Accounting for Income Taxes, has been eliminated through an adjustment to shareholder's equity. The adjustment to shareholder's equity was \$2,797,606 and \$161,506 for the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003, respectively.

The Federal income tax benefit (expense) for the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003 is comprised of the following:

	Eleven-month period ended December 31, 2003	Year ended January 31, 2003
Current	\$ 2,796,806	161,506
Deferred	(2,762,878)	(6,698)
	<u>\$ 33,928</u>	<u>154,808</u>

The Company's effective tax rate approximated the U.S. Federal income tax rate of 35%. Temporary differences that give rise to the deferred tax liability result primarily from differences in the financial and tax reporting of amortization expense of costs to acquire initial care contracts. State income taxes are not significant.

Income tax benefit was \$33,928 and \$154,808 for the eleven-month period ended December 31, 2003 and year ended January 31, 2003, respectively, and differed from the amounts computed by applying the U.S. Federal income tax rate of 35% to pretax income from continuing operations as a result of the following:

	Eleven-month period ended December 31, 2003	Year ended January 31, 2003
Computed "expected" tax benefit	\$ (39,976)	(154,808)
Increase (reduction) in income tax benefit resulting from:		
State and local income taxes, net of Federal income tax expense	520	—
Non-deductible meals and entertainment	5,528	—
	<u>\$ (33,928)</u>	<u>(154,808)</u>

CC-PALO ALTO, INC.**Notes to Financial Statements****December 31, 2003 and January 31, 2003****(6) Transactions with Related Parties**

Classic Residence Management Limited Partnership (Classic), an affiliate of the Company, contracts with third parties on behalf of the Company to provide property, health and liability insurance, and various marketing and other services. Classic advances the funds to the third parties and is reimbursed by the Company. Reimbursement to Classic for such advances amounted to \$1,804,409 and \$1,551,948 for the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003, respectively. There is no interest associated with these advances as they are reimbursed on a current basis.

Amounts due to Classic of \$99,824 and \$45,339 at December 31, 2003 and January 31, 2003, respectively, are included in accrued expenses in the accompanying balance sheets.

The Company entered into a marketing agreement dated August 1, 2000 between the Company and Classic, whereby Classic markets the independent living units of the community. The agreement is for a term of fifty-five years. The agreement requires the Company to pay Classic a marketing fee equal to 6% of the resident entrance fee of each independent living unit upon initial occupancy and 3% of the resident entrance fee of each independent living unit subsequent to initial occupancy. The agreement requires that the Company pay Classic \$738,978 per month for twenty-four months as an advance on the marketing fees. For the eleven-month period ended December 31, 2003, \$3,694,892 had been advanced to Classic and is included in prepaid marketing fees.

The Company also entered into a development management agreement dated June 30, 2003 between the Company and Classic whereby Classic manages the development of the Community. The agreement requires the Company to pay Classic a fee of \$10,061,000. The fee is to be paid in twenty-four monthly installments of \$25,000, beginning with the commencement of construction of the community in July 2003. The balance of the fee is to be paid upon the repayment of the construction loan (note 3). For the eleven-month period ended December 31, 2003, \$125,000 has been paid to Classic and is included in construction in progress.

(7) Long-term Receivable

On April 12, 2001, the Company entered into a note agreement (the Note) to loan \$960,000 to a key employee. The stated rate on the Note is 4.4%, the Applicable Federal Rate on the date of the Note. For financial reporting purposes, the Note has been recorded at its fair market value as of the date of the Note, using a rate of 7.31%, which approximates a market rate of interest for a loan of this nature at that date. The difference between the fair market value of the Note and the stated value upon execution of the Note had been recorded as deferred compensation of \$278,382 in 2002. The deferred compensation is being amortized using the straight-line method over the term of the Note. For the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003, deferred compensation of \$51,038 and \$55,682, respectively, has been capitalized to costs of acquiring initial continuing care contracts. The Note is collateralized by a first mortgage on the employee's home, provides for monthly payments of \$2,200, which includes payments of property taxes and insurance, and matures on April 12, 2006, at which time all unpaid principal and interest is due.

CC-PALO ALTO, INC.

Notes to Financial Statements

December 31, 2003 and January 31, 2003

(8) Defined Contribution Plan

The employees of the Company participate in a savings plan (the Plan) administered by Classic. The Plan is qualified under Section 401(k) of the Internal Revenue Code for all full-time employees who are 21 years of age with six months of service. The Plan allows eligible employees to defer up to 25% of their income on a pretax basis through contributions to the Plan. In accordance with the provisions of the Plan, for every dollar the employee contributes, the Company may match each participant's contribution in an amount equal to 50% of the participant's deferral, limited to 3% of a participant's salary. The Company may also make discretionary contributions to the Plan. For the eleven-month period ended December 31, 2003 and for the year ended January 31, 2003, the Company recorded contribution expense of \$24,005 and \$33,478, respectively. Discretionary contributions are funded on a current basis.

(9) Commitments and Contingencies

As of December 31, 2003, the Company was committed under the terms of construction contracts to complete the development of the Community at a remaining aggregate cost of \$150,644,642.

CC-PALO ALTO, INC.

Financial Statements

January 31, 2003 and 2002

(With Independent Auditors' Report Thereon)

CC-PALO ALTO INC.

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Independent Auditors' Report

The Board of Directors
CC-Palo Alto, Inc.:

We have audited the accompanying balance sheets of CC-Palo Alto, Inc. (the Company) as of January 31, 2003 and 2002 and the related statements of operations, changes in shareholder's equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CC-Palo Alto, Inc. as of January 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

May 30, 2003



KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is a member of KPMG International, a Swiss association.

CC-PALO ALTO, INC.

Balance Sheets

January 31, 2003 and 2002

Assets	2003	2002
Current assets:		
Cash and cash equivalents	\$ 2,431	—
Property and equipment:		
Construction in progress	11,275,531	4,524,560
Property and equipment, net of accumulated depreciation of \$22,589 and \$8,389, respectively	65,221	45,821
Total property and equipment	11,340,752	4,570,381
Other assets:		
Restricted escrow cash	68,355,419	879,087
Long-term receivable	744,030	703,316
Deferred compensation, net	190,220	245,902
Costs of acquiring initial continuing care contracts	2,526,145	1,269,880
Deposits	1,005,500	5,500
Total assets	\$ 84,164,497	7,674,066
Liabilities and Shareholder's Equity		
Current liabilities:		
Accounts payable	\$ 12,159	5,766
Construction costs payable	—	226,651
Accrued costs of acquiring initial continuing care contracts	1,167	93,216
Accrued expenses	64,270	57,642
Due to Parent	—	6,707,984
Total current liabilities	77,596	7,091,259
Deferred tax liability	9,218	2,520
Escrow deposits	68,355,419	879,087
Total liabilities	68,442,233	7,972,866
Shareholder's equity:		
Common stock, no par value. Authorized, issued, and outstanding 100 shares	—	—
Capital in excess of par	16,470,072	—
Accumulated deficit	(747,808)	(298,800)
Total shareholder's equity	15,722,264	(298,800)
Total liabilities and shareholder's equity	\$ 84,164,497	7,674,066

See accompanying notes to financial statements.

CC-PALO ALTO, INC.**Statements of Operations****Years ended January 31, 2003 and 2002**

	<u>2003</u>	<u>2002</u>
Revenue:		
Interest income	\$ 52,777	37,100
Other income	88,549	—
	<u>141,326</u>	<u>37,100</u>
Expenses:		
Administrative	235,211	128,968
Advertising	334,225	172,137
Depreciation	14,200	6,905
	<u>(442,310)</u>	<u>(270,910)</u>
Loss before income tax benefit	(442,310)	(270,910)
Income tax benefit	154,808	94,819
Net loss	<u>\$ (287,502)</u>	<u>(176,091)</u>

See accompanying notes to financial statements.

CC-PALO ALTO, INC.
Statements of Changes in Shareholder's Equity
Years ended January 31, 2003 and 2002

	Common stock		Capital in excess of par	Accumulated deficit	Total
	Shares	Amount			
Balance at January 31, 2001	100	\$ —	—	(25,110)	(25,110)
Tax adjustment	—	—	—	(97,599)	(97,599)
Net loss	—	—	—	(176,091)	(176,091)
Balance at January 31, 2002	100	—	—	(298,800)	(298,800)
Contribution from Parent	—	—	16,470,072	—	16,470,072
Tax adjustment	—	—	—	(161,506)	(161,506)
Net loss	—	—	—	(287,502)	(287,502)
Balance at January 31, 2003	100	\$ —	16,470,072	(747,808)	15,722,264

See accompanying notes to financial statements.

CC-PALO ALTO, INC.**Statements of Cash Flows**

Years ended January 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Net loss	\$ (287,502)	(176,091)
Adjustment to reconcile net loss to net cash used in operating activities:		
Depreciation	14,200	6,905
Deferred tax liability	6,698	2,520
Tax adjustment	(161,506)	(97,599)
Changes in operating assets and liabilities:		
Security deposits	—	(5,500)
Accounts payable	6,393	70,616
Accrued expenses	6,628	34,714
Net cash used in operating activities	<u>(415,089)</u>	<u>(164,435)</u>
Cash flows from investing activities:		
Construction in progress, net of related construction costs payable	(7,977,622)	(3,394,130)
Purchase of property and equipment	(33,600)	(39,372)
Costs of acquiring initial continuing care contracts, net of change in related accrual	(1,292,632)	(311,973)
Funding of long-term receivable	—	(960,000)
Repayment of long-term receivable, net of change in accrued interest	(40,714)	(21,698)
Funding of restricted escrow cash	(66,610,589)	(879,087)
Increase in escrow deposits liability	66,610,589	879,087
Net cash used in investing activities	<u>(9,344,568)</u>	<u>(4,727,173)</u>
Cash flows from financing activities:		
Contribution from Parent	9,762,088	—
Increase in due from Parent	—	4,891,608
Net cash provided by financing activities	<u>9,762,088</u>	<u>4,891,608</u>
Net increase in cash and cash equivalents	2,431	—
Cash and cash equivalents, beginning of year	—	—
Cash and cash equivalents, end of year	<u>\$ 2,431</u>	<u>—</u>
Non-cash investing activity:		
Deferred compensation capitalized to costs of acquiring continuing care contracts	\$ 55,682	32,480
Non-cash financing activity:		
Transfer of Due to Parent to Parent	6,707,984	—

See accompanying notes to financial statements.

CC-PALO ALTO, INC.

Notes to Financial Statements

January 31, 2003 and 2002

(1) Purpose and Organization

CC-Palo Alto, Inc. (the Company) is a wholly owned subsidiary of CC-Development Group, Inc. (the Parent). The Company, a Delaware corporation, was incorporated on June 23, 1999 for the purpose of developing, owning, and operating a 494-unit senior living community (the Community) in Palo Alto, California. Construction of the Community is expected to begin in 2003 with operations expected to commence in 2005.

(2) Summary of Significant Accounting Principles

(a) Use of Estimates in Preparation of Financial Statements

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

(b) Cash and Cash Equivalents

The Company considers all investments purchased with a maturity of three months or less to be cash equivalents.

(c) Property and Equipment

Property and equipment is stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. Construction in progress represents costs capitalized that were incurred to ready the property for development.

(d) Impairment of Long-lived Assets

SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, provides a single accounting model for long-lived assets to be disposed of. SFAS No. 144 also changes the criteria for classifying an asset as held for sale; and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations. The Company adopted SFAS No. 144 on February 1, 2002. The adoption of SFAS No. 144 did not affect the Company's financial statements.

In accordance with SFAS No. 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The Company does not believe that there are any factors or circumstances indicating impairment of its property and equipment as of January 31, 2003.

CC-PALO ALTO, INC.

Notes to Financial Statements

January 31, 2003 and 2002

Prior to the adoption of SFAS No. 144, the Company accounted for long-lived assets in accordance with SFAS No. 121, *Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*.

(e) *Restricted Escrow Cash*

Restricted cash consists of good faith deposits that are received by the Company upon the commitment of prospective residents to enter into a residency agreement. These funds are placed in an interest bearing escrow account, as required by the Department of Social Services of the State of California and are available to the Company once certain conditions are met.

(f) *Costs of Acquiring Initial Continuing Care Contracts*

Costs of acquiring initial continuing care contracts (the Costs) consist principally of marketing and advertising costs incurred directly in relation to the initial acquisition of continuing care contracts. The Costs will be amortized using the straight-line method over a period of ten years, beginning in the first period in which revenues associated with the Costs are earned.

(g) *Income Taxes*

Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred income taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

(h) *Concentrations of Credit Risk*

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of restricted cash held in escrow. The Company's restricted cash is held in a money market account with Commonwealth Land Title Escrow Company. Management believes credit risk related to this restricted cash to be minimal.

(3) *Ground Lease*

On August 1, 2000, the Company entered into a 75-year ground lease agreement with Stanford University. The lease calls for monthly payments of \$125,000 beginning with the commencement of the construction of the Community. It is anticipated that the construction of the Community will commence in 2003. In addition, participating rent of 6% of all gross receipts is payable monthly beginning with the Initial Occupancy. In February 2002, the Company paid a \$1,000,000 deposit as required by the ground lease agreement. After initial occupancy, the monthly payments are adjusted every 5 years to reflect increases in the Consumer Price Index (CPI); the maximum CPI increase is 7% for a 5 year period. It is anticipated that initial occupancy, which is defined as the commencement of the Community's operations, will be in the summer of 2005.

CC-PALO ALTO, INC.**Notes to Financial Statements**

January 31, 2003 and 2002

(4) Income Taxes

The operating results of the Company are included in the Parent's consolidated Federal income tax return. The Company is party to a tax-sharing agreement that provides that, among other things, the Company shall not be entitled to any reimbursement for utilization of its tax attributes in the consolidated Federal income tax return of the Parent. The Company is required to pay the Parent for any tax liability that may arise from its operations, computed on a separate return basis. For the years ended January 31, 2003 and 2002, the Company sustained losses for Federal income tax purposes. For the years ended January 31, 2003 and 2002, the current Federal income tax benefit attributable to the Company in the Parent company's consolidated Federal income tax return, as required pursuant to the provision of Statement of Accounting Standards No. 109, *Accounting for Income Taxes*, has been eliminated through an adjustment to shareholder's equity. The adjustment to shareholder's equity was \$161,506 and \$97,599 for the years ended January 31, 2003 and 2002, respectively.

The Federal income tax benefit (expense) for the years ended January 31, 2003 and 2002 is comprised of the following:

	<u>2003</u>	<u>2002</u>
Current	\$ 161,506	97,599
Deferred	<u>(6,698)</u>	<u>(2,780)</u>
	<u>\$ 154,808</u>	<u>94,819</u>

The Company's effective tax rate approximated the U.S. Federal income tax rate of 35%. Temporary differences that give rise to the deferred tax liability result primarily from differences in the financial and tax reporting of depreciation. State income taxes are not significant.

(5) Transactions with Related Parties

Classic Residence Management L.P. (Classic), an affiliate of the Company, contracts with third parties on behalf of the Company to provide property, health and liability insurance and various marketing, and other services. Classic advances the funds to the third parties and is reimbursed by the Company. Reimbursement to Classic for such advances amounted to \$1,551,948 and \$834,761 for the years ended January 31, 2003 and 2002, respectively. There is no interest associated with these advances as they are reimbursed on a current basis.

(6) Long-term Receivable

On April 12, 2001, the Company entered into a note agreement (the Note) to loan \$960,000 to a key employee. The stated rate on the Note is 4.4%, the Applicable Federal Rate on the date of the Note. For financial reporting purposes, the Note has been recorded at its fair market value as of the date of the Note, using a rate of 7.31%, which approximates a market rate of interest for a loan of this nature at that date. The difference between the fair market value of the Note and the stated value upon execution of the Note had been recorded as deferred compensation of \$278,382 in 2002. The deferred compensation is being amortized using the straight-line method over the term of the Note. For the years ended January 31, 2003 and 2002, deferred compensation of \$55,682 and \$32,480, respectively, has been capitalized to costs of

CC-PALO ALTO, INC.

Notes to Financial Statements

January 31, 2003 and 2002

acquiring initial continuing care contracts. The Note is collateralized by a first mortgage on the employee's home; provides for monthly payments of \$2,200, which includes payments of property taxes and insurance; and matures on April 12, 2006, at which time all unpaid principal and interest is due.

(7) Defined Contribution Plan

The employees of the Company participate in a savings plan (the Plan) administered by Classic. The Plan is qualified under Section 401(k) of the Internal Revenue Code for all full-time employees who are 21 years of age with six months of service. The Plan allows eligible employees to defer up to 25% of their income on a pretax basis through contributions to the Plan. In accordance with the provisions of the Plan, for every dollar the employee contributes, the Company may match each participant's contribution in an amount equal to 50% of the participant's deferral, limited to 3% of a participant's salary. The Company may also make discretionary contributions to the Plan. For the years ended January 31, 2003 and 2002, the Company recorded contribution expense of \$40,072 and \$24,793, respectively. Discretionary contributions are funded on a current basis.

**Amendment to Section 8.5.2
of the Continuing Care Residency Contract
for
Classic Residence by Hyatt in Palo Alto**

This Amendment is made between CC-Palo Alto, Inc. (the "Provider"), through its agent, Classic Residence Management Limited Partnership, d/b/a "Classic Residence by Hyatt" and Burton and Laurose Richter (collectively, "You" or "Resident").

A. On June 16, 2005, You executed a Continuing Care Residency Contract (the "Residency Contract") with Provider to reside and receive services at Classic Residence by Hyatt in Palo Alto, a continuing care retirement community located at 620 Sand Hill Road, Palo Alto, California (the "Community").

B. Section 8.5.2 of the Residency Contract provides that, in certain circumstances, Provider will repay to You a portion of your Entrance Fee known as the Repayment Amount. In the circumstances described in Section 8.5.2 of your Residency Contract, that repayment would be due and payable to You upon the earlier of: (i) re-sale of your Home or (ii) 25 years after the date You make your Home available to Provider.

C. Provider has received approval from the California Department of Social Services to change its form of Continuing Care Residency Contract so that, in Section 8.5.2, the time-frame in clause (ii) above is 10 years rather than 25 years. In addition to changing its form of Continuing Care Residency Contract going forward, Provider is offering this Amendment to those residents who have already signed a Continuing Care Residency Contract to give those residents the option to have the benefit of this change.

Therefore, the parties agree as follows:

1. Defined Terms. Terms capitalized but not defined herein, will have the meaning set forth in the Residency Contract.
2. Timing of Repayment Pursuant to Subsection 8.5.2. Subsection 8.5.2 of the Residency Contract is hereby deleted and replaced with the following text. To assist the reader, the changed portion of the following text is indicated in bold and underline.

8.5.2 Sections 8.2., 8.3., 8.4.2.h and 8.4.2.i When this Contract is terminated pursuant to Section 8.2 (*Termination After Occupancy*), Section 8.3 (*Termination Resulting from Resident's Death*), Section 8.4.2.h, or Section 8.4.2.i, You or Your estate will be entitled to repayment of a portion of Your Entrance Fee (the "Repayment Amount"). Your Repayment Amount shall be calculated as follows: (a) the greater of (i) the amount of Your Entrance Fee Note times the Minimum Repayment Percentage, and (ii) the amount of Your Entrance Fee Note minus the product of the principal amount of the Entrance Fee Note and the Amortization Rate for each Month (see Appendix G) from the Occupancy Date; minus (b) all outstanding Monthly Fees, Miscellaneous Expenses, Deferred Charges and other charges owing to Provider. Examples of the application of this Section are set forth on Appendix G. Repayments shall be paid to You on the earlier of: (i) fourteen (14) calendar days after the Provider enters into a

the earlier of: (i) fourteen (14) calendar days after the Provider enters into a residency contract covering Your former Home with a new resident who has executed a continuing care residency contract and paid the applicable Entrance Fee for Your former Home; or (ii) ten (10) years after the date You make Your Home available to the Provider. However, notwithstanding the forgoing repayment mechanism, (1) repayments upon a termination of this Contract due to a fire or other casualty (See Section 8.4.2.h) shall be paid in accordance with Section 5.2 (*Damage to Home or Community*) above without any contingency for entering into a residency contract covering Your former Home with a new resident and (2) repayments upon termination of this Contract due to a condemnation or appropriation (See Section 8.4.2.i) shall be paid within ninety (90) days after termination of this Contract without any contingency for entering into a residency contract covering Your former Home with a new resident.

Dated: 22 August 2005

RESIDENT(S):

Burton Richter
(Signature of Resident)

Burton Richter

Laurose Richter
(Signature of Resident)

Laurose Richter

PROVIDER:
CC-Palo Alto, Inc.

By: Classic Residence Management Limited Partnership
Its: Agent

By: Stewart Ingram
Stewart Ingram, Executive Director