The Village at Rockville, Inc.

Financial Statements

December 31, 2017 and 2016

BAKER TILLY

Candor. Insight. Results.

Independent Auditors' Report

Board of Trustees
The Village at Rockville, Inc.

We have audited the accompanying financial statements of The Village at Rockville, Inc., a non-profit organization, which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Village at Rockville, Inc. as of December 31, 2017 and 2016, and the results of its operations, changes in net assets, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Wyomissing, Pennsylvania
April 19, 2018

The Village at Rockville, Inc.

Balance Sheets

December 31, 2017 and 2016

	2017	2016
Assets		
Current Assets		
Cash and cash equivalents	$ 1,364,448	$ 222,748
Accounts receivable, net	1,827,930	2,026,400
Inventory	124,649	139,342
Prepaid expenses and other assets	222,165	354,298
Current portion of pledges receivable	25,364	17,852
Current portion of assets whose use is limited	895,742	889,430
Total current assets	4,460,298	3,650,070
Assets Whose Use is Limited, Net	7,377,292	5,304,029
Investments	15,427,781	17,678,647
Property and Equipment, Net	52,431,925	52,692,222
Funds Held in Trust by Others	1,984,790	1,939,999
Pledges Receivable, Net	14,833	14,410
Deferred Marketing Costs	1,321,392	385,379
Total assets	$ 83,018,311	$ 81,664,756

	2017	2016
Liabilities and Net Assets		
Current Liabilities		
Accounts payable, trade	$ 703,235	$ 603,637
Accrued interest	520,742	529,430
Accrued expenses	1,680,988	1,371,152
Current portion of long-term debt	375,000	360,000
Current portion of annuities payable	35,350	38,885
Total current liabilities	3,315,315	2,903,104
Deferred Revenue from Entrance Fees	9,160,987	10,448,277
Resident Deposits	2,131,583	-
Long-Term Debt, Net	19,860,419	20,204,186
Due to Affiliates, Net	15,258,130	9,026,409
Annuities Payable, Net	187,563	219,431
Total liabilities	49,913,997	42,801,407
Net Assets		
Unrestricted	29,359,720	35,619,466
Temporarily restricted	1,495,885	994,624
Permanently restricted	2,248,709	2,249,259
Total net assets	33,104,314	38,863,349
Total liabilities and net assets	$ 83,018,311	$ 81,664,756

See notes to financial statements

The Village at Rockville, Inc.

Statements of Operations
Years Ended December 31, 2017 and 2016

	2017	2016
Unrestricted Revenues		
Net resident service revenues	$ 26,180,223	$ 27,276,731
Contributions	108,042	116,241
Interest and dividends	471,024	432,915
Realized gains	763,676	123,914
Other income	16,619	4,399
Gain on sale or disposal of property and equipment	14,551	-
Net assets released from restriction - operations	157,030	15,992
Total unrestricted revenues	27,711,165	27,970,192
Expenses		
Salaries and wages	13,890,740	14,483,732
Employee benefits and payroll taxes	3,378,435	3,499,576
Medicare services	2,651,395	2,943,244
Other resident costs	664,363	650,939
Professional fees	237,084	310,224
Supplies	558,341	591,680
Food services	1,003,592	989,385
Utilities and other occupancy	1,455,476	1,314,010
Depreciation	4,193,651	4,177,901
Interest	1,264,682	1,288,886
Insurance and licenses	136,340	167,597
Minor equipment	84,324	93,102
Repairs and maintenance	605,396	646,654
Advertising and recruitment	158,537	215,718
Data processing	421,168	414,624
Legal and accounting	43,422	53,431
Dues and subscriptions	413,123	406,707
Miscellaneous	163,451	226,752
Bad debt expense	1,275,243	677,015
Management fee	2,441,043	2,197,157
Annuities	7,592	30,192
Total expenses	35,047,398	35,378,526
Operating loss	(7,336,233)	(7,408,334)
Unrealized Gains	1,076,487	990,526
Change in unrestricted net assets	$ (6,259,746)	$ (6,417,808)

See notes to financial statements

The Village at Rockville, Inc.

Statements of Changes in Net Assets

Years ended December 31, 2017 and 2016

	2017	2016
Unrestricted Net Assets		
Operating loss	$ (7,336,233)	$ (7,408,334)
Unrealized gains	1,076,487	990,526
Change in unrestricted net assets	(6,259,746)	(6,417,808)
Temporarily Restricted Net Assets		
Contributions	570,325	225,362
Change in value of funds held in trust by others	87,966	(21,819)
Distributions of funds held in trust by others	-	(271,783)
Net assets released from restriction - operations	(157,030)	(15,992)
Change in temporarily restricted net assets	501,261	(84,232)
Permanently Restricted Net Assets		
Contributions	42,625	286,992
Contributions of funds held in trust by others	-	128,281
Change in value of funds held in trust by others	(43,175)	(19,972)
Change in permanently restricted net assets	(550)	395,301
Change in net assets	(5,759,035)	(6,106,739)
Net Assets, Beginning	38,863,349	44,970,088
Net Assets, Ending	$ 33,104,314	$ 38,863,349

See notes to financial statements

The Village at Rockville, Inc.

Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities		
Change in net assets	$ (5,759,035)	$ (6,106,739)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	4,193,651	4,177,901
Amortization of deferred financing costs	31,233	31,233
Amortization of entrance fees	(1,174,008)	(2,124,898)
Proceeds from entrance fees	382,000	1,604,000
Realized gains	(763,676)	(123,914)
Unrealized gains	(1,076,487)	(990,526)
Contributions permanently restricted by donor	(42,625)	(286,992)
Contributions of funds held in trust by others	-	(128,281)
Change in allowance for uncollectible accounts receivable	410,984	(96,952)
Change in value of funds held in trust by others	(44,791)	41,791
Change in annuities payable	(35,403)	(8,651)
Gain on sale or disposal of property and equipment	(14,551)	-
Changes in assets and liabilities:		
Accounts receivable	(212,514)	(229,349)
Inventory, prepaid expenses and other assets	146,826	203,178
Accounts payable and accrued expenses	400,746	(220,947)
Net cash used in operating activities	(3,557,650)	(4,259,146)
Cash Flows from Investing Activities		
Net proceeds from sales of investments and assets whose use is limited	2,011,454	872,935
Purchases of property and equipment	(3,933,354)	(1,428,626)
Proceeds from sale of property and equipment	14,551	-
Payment of deferred marketing costs	(936,013)	(377,811)
Net cash used in investing activities	(2,843,362)	(933,502)
Cash Flows from Financing Activities		
Principal payments on long-term debt	(360,000)	(340,000)
Net change in resident deposits	2,131,583	-
Refunds of entrance fees	(495,282)	(253,330)
Contributions permanently restricted by donor	42,625	286,992
Cash received from funds held in trust by others	-	271,783
Change in pledges receivable, net	(7,935)	(27,577)
Change in due to affiliates, net	6,231,721	5,472,694
Net cash provided by financing activities	7,542,712	5,410,562
Net change in cash and cash equivalents	1,141,700	217,914
Cash and Cash Equivalents, Beginning	222,748	4,834
Cash and Cash Equivalents, Ending	$ 1,364,448	$ 222,748
Supplementary Cash Flows Information		
Interest paid	$ 1,242,137	$ 1,262,403

See notes to financial statements

1. Organization and Summary of Significant Accounting Policies

Organization

The Village at Rockville, Inc. (the "Organization") is a not-for-profit corporation, originally incorporated in the District of Columbia in 1890 and moved to its present location of Rockville, Maryland in 1980. The Organization operates a retirement community in Rockville, Maryland which includes 144 independent living units, 50 assisted living units, and 160 skilled nursing beds.

National Lutheran, Inc. ("NLI") is a not-for-profit Maryland corporation affiliated with the Evangelical Lutheran Church in America ("ELCA") and functions in accordance with Church body criteria and provisions. The Members of NLI are the Delaware-Maryland Synod, Metropolitan Washington, DC Synod, and the Virginia Synod of the ELCA.

NLI is the parent corporation and sole member of the Organization, which is a member of a system doing business as National Lutheran Communities and Services ("NLCS"). As a member of NLCS, the Organization shares in the control, support, and services of NLCS.

Use of Estimates

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 Organization considers all highly liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents, excluding those classified as investments and assets whose use is limited.

Accounts Receivable

Accounts receivable for services provided to residents consists of amounts owed directly from residents on a private pay basis and amounts owed from third-party payors on behalf of residents. Receivables from third-party payors are recorded at established rates, net of contractual adjustments specific to each payor. Receivables from private pay residents are recorded at established rates. Receivables are considered to be past due when payments have not been received by the Organization by their contractually stated due date. An allowance for uncollectible accounts receivable is based on management's assessment of the collectibility of individual receivables and the aggregate aging of all of the accounts receivable and was $933,139 and $522,155 at December 31, 2017 and 2016, respectively. Losses are charged against the allowance for uncollectible accounts receivable when management believes the uncollectibility of a receivable is confirmed.

Assets Whose Use is Limited, Investment Risk and Investments

Assets held as operating reserves and assets held under indenture agreements are classified as assets whose use is limited and are reported separately in the accompanying balance sheets. Assets whose use is limited that are required for obligations classified as current liabilities are reported as current assets. Investments and assets whose use is limited are reported in the accompanying balance sheets at their fair value, based on quoted market prices as provided by a national exchange, excluding alternative investments which are valued at net asset value per share ("NAV"). A decline in market value of any investment below cost that is deemed to be other-than-temporary results in a reduction in carrying value to fair value. The impairment is charged to other-than-temporary losses and a new cost basis for the investment is established.

The Organization's investments are comprised of a variety of financial instruments and are managed by third-party investment advisors. The fair values reported in the balance sheets are subject to various risks including changes in the equity markets, the interest rate environment, and general economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is reasonably possible that the amounts reported in the balance sheets could change materially in the near term.

Property and Equipment

Property and equipment are reported at cost. Depreciation is computed using the straight-line method at rates calculated to amortize the cost of the assets over their estimated useful lives. The Organization's capitalization policy is to review invoices in excess of $5,000 to determine if they should be capitalized. The general range of estimated useful lives is five to twenty years for furniture and equipment and fifteen to forty years for buildings and building and land improvements. Expenditures that extend the useful lives of the asset or significantly increase their capacity are capitalized.

Property and equipment are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If the expected cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of the assets.

Pledges Receivable

Pledges receivable are stated at outstanding balances and are discounted for their present value. Unpaid balances remaining after the stated payment terms are considered past due. Recoveries of previously charged off accounts are recorded when received. An allowance for uncollectible pledges is based on management's assessment of the collectability of pledges receivable and was $4,467 and $3,585 at December 31, 2017 and 2016, respectively.

Deferred Marketing Costs

Costs associated with marketing new independent living units (as described in Note 3) until substantially occupied or one year after completion are being accumulated as costs of acquiring initial continuing care contracts. Amortization of the costs will begin when the independent living units are substantially occupied, and the costs will be amortized over the weighted average life expectancy of the initial resident population. Capitalized costs totaled $1,321,392 and $385,379 at December 31, 2017 and 2016, respectively.

Funds Held in Trust by Others

The Organization has been named as a beneficiary of a number of perpetual and charitable remainder trusts which are administered and controlled by independent trustees. The trusts are recorded as contribution revenue when the Organization is notified of the trust's existence. The Organization receives the distributions of earnings from perpetual trusts whose principal is to be held in perpetuity. The earnings from these trusts are recorded as investment income. Depending upon the terms of the remainder trusts, the Organization may receive payments over a specified period of time or at a future date.

Perpetual trusts are valued based upon the fair value of the underlying investments. The change in the fair value of perpetual trusts is reported as a change in permanently restricted net assets. The fair value of remainder trusts are based upon a calculation of the present value of the estimated future benefits to be received when the trust’s assets are distributed and are recorded as temporarily restricted net assets.

Gift Annuities

Liabilities related to gift annuities issued by the Organization are recorded at the present value of the future payments based on the donor’s life expectancy. Amounts donated in excess of the liability are recorded as unrestricted donations in the statements of operations. The Organization uses published mortality tables adopted by the United States Internal Revenue Service and an assumed discount rate of approximately 0.05% to 7.50% to determine the present value of the actuarially determined liability. Maryland regulations require a segregated reserve fund with assets at least equal to fund adequate reserves on its outstanding annuity agreement which the Organization maintains in compliance with this requirement.

Entrance Fees

The Organization’s Independent Living admissions policy requires the payment of an entrance fee for admittance. These entrance fees are accounted for as deferred revenue. The entrance fee is a type C fee-for-service contract. Entrance fees are partially refundable upon a resident’s withdrawal from an independent living unit. The refundable portion is calculated based on a ten year amortization period after applying 20% of the initial entrance fee, which is nonrefundable. Deferred revenue from entrance fees is amortized to earned revenue using the straight-line method over the estimated remaining life expectancy of the residents. At the time of death or contract termination, the remaining nonrefundable balance is recognized as revenue. The remaining life expectancy of the residents is adjusted annually based on actuarial information. Contractual refund obligations approximate $7,194,000 and $8,400,000 at December 31, 2017 and 2016, respectively.

The Organization also has a rental agreement requiring no entrance fee.

Deferred Financing Costs

Financing costs of $893,794 were incurred in connection with the issuance of long-term debt. These costs are reported in the accompanying balance sheets as a reduction of long-term debt and are being amortized over the life of the debt using the straight-line method, which approximates the effective interest method. The amortization of deferred financing costs, included in interest expense on the accompanying statements of operations, totaled $31,233 both in 2017 and 2016. Accumulated amortization was $144,213 and $112,980 at December 31, 2017 and 2016, respectively.

Net Assets

There are three classes of net assets - permanently restricted, temporarily restricted, and unrestricted. Net assets, revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions:

Permanently restricted net assets, Net assets subject to donor-imposed stipulations that are required to be maintained in perpetuity by the Organization. Generally, the donors of these assets permit the institution to use all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted net assets subject to donor-imposed stipulation and/or the passage of time.

Unrestricted net assets are net assets not subject to donor-imposed stipulations. The Board of Trustees may, at its discretion, designate unrestricted funds for mission related purposes.

Donor Restrictions

The Organization reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (that is, when a stipulated time restriction ends or a purpose restriction is accomplished), temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions.

The Organization reports gifts of property and equipment (or other long-lived assets) as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. The Organization reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Donated Services

A significant number of volunteers annually donate their services to the Organization. The value of these services is not reflected in the financial statements because they do not meet the criteria to recognize them as requiring specialized skills and knowledge that the Organization would have purchased.

Net Resident Service Revenue

Independent Living is a fee-for-service program that requires monthly fee payments based on established rates. These monthly fees are not attributable as prepayment for nursing care. Independent Living residents who wish to transfer to the skilled nursing facility or assisted living may apply for admission. At the date of admission to the assisted living or skilled nursing facility, if there is a remaining entrance fee balance on the resident's independent living unit, that balance is applied as a credit against the monthly fee.

Skilled nursing services revenue is reported at the estimated net realizable amounts from residents, third-party payors, and others for services rendered. Revenue under third-party payor agreements is subject to audit and retroactive adjustment. Provisions for estimated retroactive adjustments, if any, are reported in the year of final determination as an adjustment of skilled nursing services revenue. A summary of the principal payment arrangements with third-party payors is as follows:

- Medical Assistance: Under the Maryland Medical Assistance Program's case-mix reimbursement system, the determination of reimbursement rates for skilled nursing costs is based upon a recipient's dependency in Activities of Daily Living (ADLs), and need for and receipt of ancillary nursing services. Each recipient is assigned a reimbursement level depending on his or her degree of dependency in ADLs. Approximately 20% and 22% of net resident service revenues in 2017 and 2016, respectively, were derived from the Medical Assistance program.

- Medicare: Nursing and ancillary services provided to Medicare Part A beneficiaries are paid at prospectively determined rates per day. These rates vary according to a resident-specific classification system that is based on clinical, diagnostic, and other factors and the reimbursement methodology is subject to various limitations and adjustments. Approximately 32% and 34% of the Organization's net resident service revenues in 2017 and 2016, respectively, were derived from the Medicare Part A program.

As described above, the Medical Assistance and Medicare Part A rates are based on clinical, diagnostic, and other factors. The determination of these rates is partially based on the Organization's clinical assessment of its residents. The Organization is required to clinically assess its residents at predetermined time periods throughout the year. The documented assessments are subject to review and adjustment by the Medical Assistance and Medicare programs.

The Organization also has entered into payment agreements with certain commercial insurance carriers and others. The basis for payment to the Organization under these agreements includes prospectively determined rates per day or discounts from established charges.

Advertising

The Organization expenses advertising costs as incurred, excluding those capitalized as deferred marketing costs. Advertising expense totaled approximately $62,500 and $220,000 for the years ended December 31, 2017 and 2016, respectively.

Operating Loss

The statements of operations include the determination of operating loss. Changes in unrestricted net assets, which are excluded from operating loss, consistent with industry practice, include net unrealized gains on investments, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Tax Status

The Organization is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code ("IRC") and is exempt from federal income taxes on related income pursuant to Section 509(a) of the IRC.

Recent Accounting Pronouncements

Revenue Recognition

During May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU No. 2014-09 supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. Under the requirements of ASU No. 2014-09, the core principle is that entities should recognize revenue to depict the transfer of promised goods or services to customers (residents) in an amount that reflects the consideration at which the entity expects to be entitled in exchange for those goods or services. The Organization will be required to retrospectively adopt the guidance in ASU No. 2014-09 in the year ending December 31, 2019. The Organization is currently assessing the effect that ASU No. 2014-09 will have on its financial statements.

Presentation of Financial Statements

During August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new guidance is intended to improve and simplify the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. ASU No. 2016-14 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. ASU No. 2016-14 is to be applied retroactively with transition provisions. The Organization is currently assessing the impact this standard will have on its financial statements.

Financial Instruments

During January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* (Subtopic 825-10). ASU No. 2016-01 was issued to enhance the reporting model for financial instruments in financial statements. The provisions of ASU No. 2016-01 require marketable equity securities to be reported at fair value with changes in fair value recognized within the performance indicator, establishes a qualitative factor in evaluating impairment on equity investments without readily determinable fair values, and eliminates the requirement to disclose the fair value on financial instruments measured at amortized cost. The Organization will be required to prospectively adopt the guidance in ASU No. 2016-01 for years beginning after December 15, 2018. The Organization is currently assessing the impact that ASU No. 2016-01 will have on its financial statements.

Restricted Cash

During November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU No. 2016-18 is effective for non-public entities for fiscal years beginning after December 15, 2018, with early adoption permitted. ASU No. 2016-18 is to be applied retroactively with transition provisions. The Organization is currently assessing the impact that ASU No. 2016-18 will have on its financial statements.

Subsequent Events

The Organization has evaluated subsequent events for recognition and disclosure through April 19, 2018, which is the date the financial statements were available to be issued.

Reclassifications

Certain items in the 2016 financial statements have been reclassified to conform to the 2017 financial statement presentation. The reclassifications had no effect on the change in net assets.

2. Fair Value Measurements, Investments and Assets Whose Use is Limited, and Other Financial Instruments

Fair Value Measurements

For financial instruments required to be measured at fair value on a recurring basis, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is measured using a hierarchy prioritizing the inputs used in determining valuations into three levels. The level within the fair value hierarchy is based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are as follows:

Level 1 - Unadjusted quoted prices in active markets that are accessible to the Organization for identical instruments.

Level 2 - Significant inputs, other than Level 1 inputs that are observable either directly or indirectly for substantially the full term of the instruments through corroboration with observable market data.

Level 3 - Significant unobservable inputs.

The following tables present financial instruments measured at fair value at December 31, 2017 and 2016, by caption on the balance sheets:

	2017				
	Carrying Value	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Reported at fair value:					
Assets,					
Investments and assets whose use is limited:					
Cash and cash equivalents	$ 1,595,162	$ 1,595,162	$ 1,595,162	$ -	$ -
Equity securities	916,178	916,178	916,178	-	-
Mutual funds	1,639,121	1,639,121	1,639,121	-	-
Fixed income securities	158,393	158,393	-	158,393	-
Other	83,174	83,174	-	83,174	-
Consolidated Fund	18,532,825	18,532,825	14,037,226	4,495,599	-
Subtotal	22,924,853	22,924,853	18,187,687	4,737,166	-
Consolidated Fund alternative investments measured at NAV	775,962				
Total	23,700,815				
Funds held in trust by others	1,984,790	1,984,790	-	-	1,984,790
Total assets	$ 25,685,605	$ 24,909,643	$ 18,187,687	$ 4,737,166	$ 1,984,790

	2016				
	Carrying Value	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Reported at fair value:					
Assets,					
Investments and assets whose use is limited:					
Cash and cash equivalents	$ 1,810,278	$ 1,810,278	$ 1,810,278	$ -	$ -
Equity securities	959,686	959,686	959,686	-	
Mutual funds	1,374,689	1,374,689	1,374,689	-	-
Fixed income securities	146,888	146,888	-	146,888	-
Other	82,542	82,542	-	82,542	-
Consolidated Fund	18,387,513	18,387,513	14,080,233	4,307,280	-
Subtotal	22,761,596	22,761,596	18,224,886	4,536,710	-
Consolidated Fund alternative investments measured at NAV	1,110,510				
Total	23,872,106				
Funds held in trust by others	1,939,999	1,939,999	-	-	1,939,999
Total assets	$ 25,812,105	$ 24,701,595	$ 18,224,886	$ 4,536,710	$ 1,939,999

Investments and assets whose use is limited are presented together in the tables above as there are various investment and cash accounts that are allocated between the investment and assets whose use is limited lines on the balance sheets.

The investments and assets whose use is limited are presented on the balance sheets as follows:

	2017	**2016**
Investments	$ 17,610,853	$ 17,678,647
Assets whose use is limited:		
Operating reserve	$ 4,438,360	$ 4,512,901
Resident deposits	2,131,583	-
Assets held under trust indenture:		
Debt service reserve	750,024	780,617
Funded interest and principal	909,867	851,937
Construction and replacement	43,200	48,004
	8,273,034	6,193,459
Less current portion	(895,742)	(889,430)
Assets whose use is limited, net	$ 7,377,292	$ 5,304,029

For assets falling within the Level 3 in the fair value hierarchy, the activity recognized during the years ended December 31, 2017 and 2016 is as follows:

	Funds Held in Trust by Others
Balance as of December 31, 2015	$ 2,125,292
Purchases/contributions	128,281
Distributions	(271,783)
Change in value	(41,791)
Balance as of December 31, 2016	1,939,999
Change in value	44,791
Balance as of December 31, 2017	$ 1,984,790

The change in Level 3 assets is recorded in the statements of operations and changes in net assets as increases or decreases as follows:

	2017	2016
Temporarily restricted net assets	$ 87,966	$ (293,602)
Permanently restricted net assets	(43,175)	108,309
	$ 44,791	$ (185,293)

Certain investments are pooled with related organizations and are referred to as “Consolidated Fund” investments. Approximately 24.17% and 22.79% of the pooled investments are attributable to the Organization as of December 31, 2017 and 2016, respectively. The percentage of pooled investments is calculated based on a monthly cost basis adjusted for any deposits or withdrawals specific to the Organization. Investment income is also based on this allocation.

The following tables present the Organization's share of the pooled investments in the Consolidated Fund measured at fair value at December 31, 2017 and 2016:

	2017			
	Carrying Value	**Fair Value**	**Level 1**	**Level 2**
Consolidated Fund:				
Cash and cash equivalents	$ 1,167,238	$ 1,167,238	$ 1,167,238	$ -
Equity securities:				
Consumer discretionary	1,263,109	1,263,109	1,263,109	-
Consumer staples	282,064	282,064	282,064	-
Energy	568,997	568,997	568,997	-
Financial	788,881	788,881	788,881	-
Health care	902,303	902,303	902,303	-
Industrials	704,744	704,744	704,744	-
Information technology	1,393,654	1,393,654	1,393,654	-
Materials	297,246	297,246	297,246	-
Telecommunication	788,724	788,724	788,724	-
Utilities	677,090	677,090	677,090	-
Other	857,945	857,945	857,945	-
Mutual funds:				
Fixed income	1,774,371	1,774,371	1,774,371	-
Equity	2,570,860	2,570,860	2,570,860	-
Fixed income securities:				
Corporate bonds	2,498,113	2,498,113	-	2,498,113
U.S. Government and agency bonds	1,997,486	1,997,486	-	1,997,486
Subtotal	18,532,825	$ 18,532,825	$ 14,037,226	$ 4,495,599
Alternative investments, measured at NAV	775,962			
Total	$ 19,308,787			

	2016			
	Carrying Value	**Fair Value**	**Level 1**	**Level 2**
Consolidated Fund:				
Cash and cash equivalents	$ 925,386	$ 925,386	$ 925,386	$ -
Equity securities:				
Consumer discretionary	1,396,874	1,396,874	1,396,874	-
Consumer staples	389,735	389,735	389,735	-
Energy	867,250	867,250	867,250	-
Financial	1,471,284	1,471,284	1,471,284	-
Health care	1,168,678	1,168,678	1,168,678	-
Industrials	850,437	850,437	850,437	-
Information technology	949,795	949,795	949,795	-
Materials	365,199	365,199	365,199	-
Telecommunication	496,203	496,203	496,203	-
Utilities	277,043	277,043	277,043	-
Other	450,737	450,737	450,737	-
Mutual funds:				
Fixed income	1,729,366	1,729,366	1,729,366	-
Equity	635,209	635,209	635,209	-
Other	2,063,516	2,063,516	2,063,516	-
Exchange-traded and closed-end funds	43,521	43,521	43,521	-
Fixed income securities:				
Corporate bonds	2,525,655	2,525,655	-	2,525,655
U.S. Government and agency bonds	1,781,625	1,781,625	-	1,781,625
Subtotal	18,387,513	$ 18,387,513	$ 14,080,233	$ 4,307,280
Alternative investments, measured at NAV	1,110,510			
Total	$ 19,498,023			

Valuation Methodologies

The carrying amounts of cash and cash equivalents approximate fair value due to the short-term nature of these instruments.

Equity securities and mutual funds are valued at closing price reported on the active market on which the individual securities are traded.

Fixed income securities and other are valued at closing price reported on the active market on which the same or similar securities are traded.

The fair value of the Consolidated Fund was determined using the fair values of the investments held in the fund at the Organization's percentage of holdings, which include the following:

> Investments within the Consolidated Fund are valued at fair value based on quoted market prices in active markets for cash and cash equivalents, equity securities, mutual funds, and exchange-traded and closed-end funds; and based on quoted prices for the same or similar securities for fixed income securities.
>
> Alternative investments are comprised of hedge funds. The Organization measures the fair value of the alternative investments based on NAV as calculated on the reporting entity's measurement date. The Organization measures the fair value of an investment that does not have a readily determinable fair value, based on the NAV of the investment as a practical expedient, without further adjustment, unless it is probable that the investment will be sold at a value significantly different than the NAV. If the practical expedient NAV is not as of the reporting entity's measurement date, then the NAV is adjusted to reflect any significant events that would materially affect the value of the security and the NAV of the Organization as of the valuation date. In using the NAV as a practical expedient, certain attributes of the investment, that may impact the fair value of the investment, are not considered in measuring fair value. Attributes of those investments include the investment strategies of the investees and may also include, but are not limited to, restrictions on the investor's ability to redeem its investments at the measurement date at NAV as well as any unfunded commitments.

Fair value of funds held in trust by others is based on the fair value of the trusts' underlying assets, which approximate the present value of the future distributions expected to be received.

The fair value of due to affiliates, net does not appear in the preceding tables because as a practical matter fair value cannot be estimated since terms could not be duplicated in the market and related parties can revise terms, thereby making assumptions supporting fair values potentially unreliable.

The following table presents a list of the Organization's share of the Consolidated Fund's alternative investments as of December 31, 2017 and 2016:

Name of Fund	Fair Value December 31, 2017	Fair Value December 31, 2016	Investment Strategy	Unfunded Commitments	Redemption Frequency
Ironwood Institutional Multi Strategy Fund	$ 775,962	$ 678,154	(a)	N/A	Monthly/Quarterly 15-120 days
Skybridge Multi-Advisor Hedge Fund	-	432,356	(b)	N/A	Monthly/Quarterly 15-120 days
	$ 775,962	$ 1,110,510			

(a) Investment strategy is capital appreciation with limited variability of returns. This fund invests exclusively in other private investment companies, which invests substantially all of its assets in hedge funds and other similar investment vehicles that are managed by a select group of portfolio managers who invest in a variety of financial markets and utilize a broad range of alternative investment strategies.

(b) The investment strategy of this fund is to achieve capital appreciation principally through investing in investment funds managed by third-party investment managers that employ a variety of alternative investment strategies. These investment strategies allow investment managers the flexibility to use leverage or short-side positions to take advantage of perceived inefficiencies across the global markets, often referred to as alternative strategies. Because investment funds following alternative investment strategies are often described as hedge funds, the investment program of the fund can be described as a fund of hedge funds. The fund was redeemed during 2017.

The following table summarizes the gross unrealized losses and fair value, aggregated by investment category and length of time for individual securities in a loss position for the Organization's share in the pooled investments in the Consolidated Fund. 92 and 204 individual securities had unrealized losses at December 31, 2017 and 2016, respectively. Management believes that these holding losses are not permanently impaired as they reflect general market conditions instead of a permanent decline in value.

2017 - Consolidated Fund

	Less than Twelve Months		More than Twelve Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Equity securities	$ 62,150	$ (7,673)	$ 2,385,219	$ (202,382)	$ 2,447,469	$ (201,055)
Mutual funds	1,074,999	(8,392)	1,097,654	(18,904)	2,172,653	(27,296)
Fixed income securities	914,021	(26,970)	640,129	(98,979)	1,554,150	(125,949)
	$ 2,051,170	$ (43,035)	$ 4,123,002	$ (320,265)	$ 6,174,272	$ (354,300)

2016 - Consolidated Fund

	Less than Twelve Months		More than Twelve Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Equity securities	$ 1,092,678	$ (61,834)	$ 855,540	$ (217,759)	$ 1,948,218	$ (279,593)
Mutual funds	182,590	(7,604)	2,385,319	(202,382)	2,567,908	(209,986)
Fixed income securities	816,059	(14,657)	$ 1,097,654	(18,904)	1,913,713	(33,561)
	$ 2,091,327	$ (84,095)	$ 4,338,513	$ (439,045)	$ 6,429,839	$ (523,140)

Maryland Department of Aging Reserve Requirements

In accordance with Maryland law governing continuing care retirement communities, the Organization is required to set aside operating reserves totaling 15% of the facility's net operating expenses (as defined) for the most recent fiscal year.

The calculation of the required minimum statutory operating reserve for the year ended December 31, 2017 is as follows:

Total operating expenses for fiscal year ended December 31, 2017	$ 35,047,398
Less:	
Depreciation	(4,193,651)
Interest	(1,264,682)
Adjusted operating expense	$ 29,589,065
Funding requirement (15% of operating expenses)	$ 4,438,360

The Organization has reserved this amount in assets whose use is limited to satisfy the minimum statutory operating reserve requirement. Beginning January 1, 2023, the reserve requirement will be equal to 25% of the facility's net operating expenses.

3. Property and Equipment

A summary of property and equipment and the related accumulated depreciation is as follows at December 31, 2017 and 2016:

	2017	2016
Land	$ 3,255,295	$ 3,255,295
Land improvements	264,541	246,491
Buildings and building improvements	75,781,132	75,336,753
Furniture and equipment	9,456,706	8,990,042
Construction in progress	4,729,412	1,454,117
	93,487,086	89,282,698
Less accumulated depreciation	(41,055,161)	(36,590,476)
	$ 52,431,925	$ 52,692,222

Construction in progress at December 31, 2017 consists of initial project development costs for a planned expansion and repositioning project expecting to consist of an addition of 132 independent living units in place of 33 of its existing independent living units. In addition, the expansion phase will add additional common space, dining rooms and underground parking. The Organization is currently marketing the new independent living units and has received $2,131,583 in resident deposits primarily related to the project. No construction commitments exist as of December 31, 2017.

4. Long-Term Debt

Long-term debt, net consists of the following as of December 31, 2017 and 2016:

	2017	2016
Series 2012A Economic Development Revenue Bonds, payable in monthly installments to satisfy annual debt service requirements through February 2042. Interest is payable at fixed rates ranging from 5.96% to 7.23%.	$ 12,455,000	$ 12,650,000
Series 2012B Economic Development Revenue Bonds, payable in monthly installments to satisfy annual debt service requirements through February 2042. Interest is payable at fixed rates ranging from 4.70% to 5.61% through January 2022. Beginning in February 2022 through maturity, the interest rate will become a variable rate.	8,530,000	8,695,000
	20,985,000	21,345,000
Less: current portion	(375,000)	(360,000)
Long-term debt, excluding deferred financing costs	20,610,000	20,985,000
Deferred financing costs, net of accumulated amortization	(749,581)	(780,814)
Long-term debt, net	$ 19,860,419	$ 20,204,186

The bonds are limited offerings and are not listed on any stock or other securities exchange. As security for the payment of the bonds, the Organization will grant a lien and security interest in the mortgaged premises and assign a security interest in the pledged assets to the master trustee. Pledged assets include present and future accounts receivable, contract rights, general intangibles and the proceeds of all the foregoing. Additionally, NLI entered into a support agreement guaranteeing the repayment of the bonds as additional security. The support agreement will terminate upon the achievement of certain financial performance targets as defined in the agreement.

The long-term debt maturing in the next five years and thereafter is as follows:

2018	$ 375,000
2019	400,000
2020	425,000
2021	450,000
2022	480,000
Thereafter	18,855,000
	$ 20,985,000

Interest expense totaled $1,264,682 in 2017, and $1,288,886 in 2016 including amortization of deferred financing costs of $31,233 in both 2017 and 2016.

5. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets consist of the following as of December 31, 2017 and 2016:

	2017	2016
Funds held in trust by others	$ 421,038	$ 333,072
Capital project funds	423,370	193,174
Operating funds	651,477	468,378
	$ 1,495,885	$ 994,624

Net assets released from restriction totaled $157,030 in 2017 and $15,992 in 2016.

Permanently restricted net assets consist of the following as of December 31, 2017 and 2016:

	2017	2016
Funds held in trust by others	$ 1,563,752	$ 1,606,927
Benevolence endowment	684,957	642,332
	$ 2,248,709	$ 2,249,259

6. Related Party Transactions

NLI is the sole member of the Organization and provides support in the form of management and support services in exchange for management fees and provides additional capital support when needed. The Organization incurred management fees to NLI totaling $2,441,043 in 2017 and $2,197,157 in 2016.

Various entities that are part of the NLCS system make working capital advances to each other as needed. Related party transactions bear no interest and have no stated repayment terms

The following represents net amounts due to (from) affiliated organizations at December 31:

	2017	2016
NLI	$ 15,668,148	$ 9,024,275
The Village at Orchard Ridge, Inc.	(212,513)	-
The Legacy at North Augusta, Inc.	(156,248)	-
myPotential Virginia, LLC	(40,244)	-
myPotential Maryland, LLC	(9,147)	-
myPotential Clinic-Rockville, LLC	6,000	-
National Lutheran Home for the Aged, Inc.	2,134	2,134
	$ 15,258,130	$ 9,026,409

7. Classification of Expenses

Expenses by functional classifications for the years ended December 31, 2017 and 2016 are as follows:

	2017	2016
Program activities	$ 29,991,750	$ 30,237,697
General and administrative	5,055,648	5,140,829
	$ 35,047,398	$ 35,378,526

Fundraising expenses are incurred through NLI.

8. Pension Plan

The Organization has a 403(b) defined contribution plan. The Organization contributes 2% of the eligible employees' salaries and matches 50% of each employee's contribution up to 8% after 90 days of service for a maximum contribution of 6%. All participating employees' contributions are 100% vested and employer contributions are vested at 20% per year to 100% after 5 years. Employer contributions totaled $470,421 in 2017 and $463,046 in 2016.

9. Benevolent Care

The Organization extends charity care and other support to residents, who meet certain criteria under its benevolent care policy and are unable to pay for services, at all levels of care as needed and when appropriate without charge or at amounts less than its established rates. Because the Organization does not pursue collection of amounts determined to be benevolent care, they are not reported as resident service revenues.

The Organization maintains records to identify and monitor the level of benevolent care it provides. The estimated cost of providing benevolent care is based upon the direct and indirect costs identified with the specific benevolent care provided. The cost of benevolent care provided amounted to approximately $5,020,000 in 2017 and $4,460,000 in 2016, including approximately $4,495,000 in 2017 and $4,385,000 in 2016, respectively, related to the Medicaid program.

10. Risk

Financial instruments which subject the Organization to concentrations of credit risk consist primarily of cash and cash equivalents, investments, and receivables.

The Organization typically maintains cash and cash equivalents in local banks, which at times exceed what is insured by the Federal Deposit Insurance Corporation. The Organization has not experienced any losses from maintaining cash accounts in excess of federally insured limits. Management believes it is not subject to any significant credit risk on its cash accounts.

The Organization's investments are subject to fluctuation in the fair values of those investments.

The Organization grants credit to its residents and other third-party payors, primarily Medicare and various commercial insurance companies. The Organization maintains reserves for potential credit losses and such losses have historically been within management's expectations.

11. Medical Malpractice Claims Coverage

The Organization maintains occurrence based professional liability coverage through a commercial insurance carrier. Management believes no incidents have occurred or will be asserted that will exceed the Organization's insurance coverage or will have a material adverse effect on the financial statements.

12. Contingencies

The senior living services industry is subject to numerous laws, regulations, and administrative directives of federal, state, and local governments and agencies. Compliance with these laws, regulations, and administrative directives is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for resident services previously billed. Management is not aware of any material incidents of noncompliance; however, the possible future effect of this matter on the Organization, if any, is not presently determinable.