# The Village at Rockville, Inc.

Financial Statements

December 31, 2018 and 2017

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# Independent Auditors' Report

To the Board of Trustees of
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, 2018 and 2017, 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, 2018 and 2017, 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.

**Emphasis of a Matter**

As discussed in Note 1 to the financial statements, in 2018, The Village at Rockville, Inc. adopted new accounting guidance related to the Financial Accounting Standards Board Accounting Standard Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* Our opinion is not modified with respect to this matter.

Baker Tilly Virchow Krause, LLP

Wyomissing, Pennsylvania
April 24, 2019

## The Village at Rockville, Inc.

Balance Sheets

December 31, 2018 and 2017

| | 2018 | 2017 (As Adjusted) |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 210,152 | $ 1,364,448 |
| Accounts receivable, net | 1,935,675 | 1,827,930 |
| Prepaid expenses and other assets | 244,322 | 346,814 |
| Current portion of pledges receivable | 8,344 | 25,364 |
| Current portion of assets whose use is limited | 1,636,384 | 895,742 |
| Total current assets | 4,034,877 | 4,460,298 |
| **Assets Whose Use is Limited, Net** | 16,695,043 | 7,377,292 |
| **Investments** | 17,798,942 | 15,427,781 |
| **Property and Equipment, Net** | 53,707,399 | 52,431,925 |
| **Funds Held in Trust by Others** | 1,928,796 | 1,984,790 |
| **Pledges Receivable, Net** | - | 14,833 |
| Total assets | $ 94,165,057 | $ 81,696,919 |

| | 2018 | 2017 (As Adjusted) |
|---|---|---|
| **Liabilities and Net Assets** | | |
| **Current Liabilities** | | |
| Accounts payable, trade | $ 975,093 | $ 648,012 |
| Accounts payable, construction | 644,000 | 55,222 |
| Accrued interest | 592,384 | 520,742 |
| Accrued expenses | 1,711,597 | 1,680,989 |
| Current portion of long-term debt | 400,000 | 375,000 |
| Current portion of annuities payable | 32,540 | 35,350 |
| Total current liabilities | 4,355,614 | 3,315,315 |
| **Deferred Revenue from Entrance Fees** | 8,286,257 | 9,160,987 |
| **Refundable Entrance Fees** | 1,929,313 | - |
| **Resident Deposits** | 5,703,688 | 2,131,583 |
| **Long-Term Debt, Net** | 31,234,852 | 19,860,419 |
| **Due to Affiliates, Net** | 20,605,254 | 15,258,130 |
| **Annuities Payable, Net** | 96,623 | 187,563 |
| Total liabilities | 72,211,601 | 49,913,997 |
| **Net Assets** | | |
| Without donor restrictions | 19,100,028 | 28,038,328 |
| With donor restrictions | 2,853,428 | 3,744,594 |
| Total net assets | 21,953,456 | 31,782,922 |
| Total liabilities and net assets | $ 94,165,057 | $ 81,696,919 |

*See notes to financial statements*

## The Village at Rockville, Inc.

Statements of Operations

Years Ended December 31, 2018 and 2017

| | 2018 | 2017 (As Adjusted) |
|---|---|---|
| **Revenues Without Donor Restrictions** | | |
| Net resident service revenues | $ 27,665,676 | $ 26,175,194 |
| Contributions | 223,938 | 108,042 |
| Interest and dividends | 549,059 | 531,726 |
| Realized gains | 200,216 | 763,676 |
| Other income | 154,086 | 27,098 |
| Net assets released from restriction, operations | 441,972 | 157,030 |
| Total revenues without donor restrictions | 29,234,947 | 27,762,766 |
| **Expenses** | | |
| Salaries and wages | 14,633,483 | 13,890,740 |
| Employee benefits and payroll taxes | 3,567,943 | 3,378,435 |
| Professional fees | 1,291,037 | 1,014,624 |
| Ancillary and medical | 3,602,751 | 3,288,519 |
| Supplies | 652,930 | 522,702 |
| Food services | 1,071,859 | 1,023,294 |
| Utilities | 1,141,400 | 1,120,262 |
| Depreciation | 4,162,713 | 4,193,651 |
| Gain on sale or disposal of property and equipment | - | (14,551) |
| Interest | 1,235,470 | 1,264,682 |
| Insurance | 58,700 | 69,686 |
| Real estate taxes | 273,714 | 284,463 |
| Repairs and maintenance | 536,924 | 389,722 |
| Advertising and marketing | 724,410 | 1,035,129 |
| Licenses, dues and subscriptions | 617,553 | 537,308 |
| Other operating expenses | 359,802 | 312,468 |
| Bad debt expense | 510,341 | 1,275,243 |
| Management fee | 2,440,001 | 2,441,043 |
| Annuities | (56,073) | 7,592 |
| Total expenses | 36,824,958 | 36,035,012 |
| Operating loss | (7,590,011) | (8,272,246) |
| **Unrealized (Losses) Gains** | (1,914,745) | 1,076,487 |
| **Net Assets Released from Restriction, Capital** | 566,456 | - |
| Change in net assets without donor restrictions | $ (8,938,300) | $ (7,195,759) |

*See notes to financial statements*

## The Village at Rockville, Inc.

Statements of Changes in Net Assets
Years Ended December 31, 2018 and 2017

| | 2018 | 2017 (As Adjusted) |
|---|---|---|
| **Net Assets without Donor Restrictions** | | |
| Operating loss | $ (7,590,011) | $ (8,272,246) |
| Unrealized (losses) gains | (1,914,745) | 1,076,487 |
| Net assets released from restriction, capital | 566,456 | - |
| Change in net assets without donor restrictions | (8,938,300) | (7,195,759) |
| **Net Assets with Donor Restriction** | | |
| Contributions | 173,256 | 612,950 |
| Change in value of funds held in trust by others | (55,994) | 44,791 |
| Net assets released from restriction, operations | (441,972) | (157,030) |
| Net assets released from restriction, capital | (566,456) | - |
| Change in net assets with donor restrictions | (891,166) | 500,711 |
| Change in net assets | (9,829,466) | (6,695,048) |
| **Net Assets, Beginning as Previously Reported** | - | 38,863,349 |
| **Cumulative Effect of Change in Accounting Principle** | - | (385,379) |
| **Net Assets, Beginning as Adjusted** | 31,782,922 | 38,477,970 |
| **Net Assets, Ending** | $ 21,953,456 | $ 31,782,922 |

*See notes to financial statements*

## The Village at Rockville, Inc.

Statements of Cash Flows
Years Ended December 31, 2018 and 2017

| | 2018 | 2017 (As Adjusted) |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Change in net assets | $ (9,829,466) | $ (6,695,048) |
| Adjustments to reconcile change in net assets to net cash used in operating activities: | | |
| Depreciation | 4,162,713 | 4,193,651 |
| Amortization of deferred financing costs | 31,233 | 31,233 |
| Amortization of entrance fees | (1,475,114) | (1,174,008) |
| Proceeds from entrance fees | 944,756 | 382,000 |
| Realized gains | (200,216) | (763,676) |
| Unrealized losses (gains) | 1,914,745 | (1,076,487) |
| Donor restricted contributions | (173,256) | (612,950) |
| Change in allowance for uncollectible accounts receivable | (605,526) | 410,984 |
| Change in value of funds held in trust by others | 55,994 | (44,791) |
| Change in annuities payable | (93,750) | (35,403) |
| Gain on sale or disposal of property and equipment | - | (14,551) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 497,781 | (212,514) |
| Prepaid expenses and other assets | 102,492 | 146,826 |
| Accounts payable and accrued expenses | 429,331 | 400,746 |
| Net cash used in operating activities | (4,238,283) | (5,063,988) |
| **Cash Flows from Investing Activities** | | |
| Net (purchases) proceeds from sales of investments and assets whose use is limited | (14,144,083) | 2,011,454 |
| Purchases of property and equipment | (4,849,409) | (3,933,354) |
| Proceeds from sale of property and equipment | - | 14,551 |
| Net cash used in investing activities | (18,993,492) | (1,907,349) |
| **Cash Flows from Financing Activities** | | |
| Principal payments on long-term debt | (375,000) | (360,000) |
| Proceeds from issuance of long-term debt | 13,500,000 | - |
| Payments for financing costs | (1,756,800) | - |
| Net change in resident deposits | 3,572,105 | 2,131,583 |
| Proceeds from refundable entrance fees, turnover units | 1,929,313 | - |
| Refunds of entrance fees | (344,372) | (495,282) |
| Donor restricted contributions | 173,256 | 612,950 |
| Change in pledges receivable, net | 31,853 | (7,935) |
| Change in due to affiliates, net | 5,347,124 | 6,231,721 |
| Net cash provided by financing activities | 22,077,479 | 8,113,037 |
| Net change in cash and cash equivalents | (1,154,296) | 1,141,700 |
| **Cash and Cash Equivalents, Beginning** | 1,364,448 | 222,748 |
| **Cash and Cash Equivalents, Ending** | $ 210,152 | $ 1,364,448 |
| **Supplementary Cash Flows Information** | | |
| Interest paid, net of capitalized interest | $ 1,132,595 | $ 1,242,137 |
| **Supplementary Disclosure of Noncash Investing and Financing Activities** | | |
| Accounts payable, construction | $ 644,000 | $ 55,222 |

*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"). 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 consist 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. The Organization assesses collectability on all resident accounts prior to providing services. An allowance for uncollectible accounts is recognized to reduce accounts receivable to its net realizable value for impairment of revenues for changes in resident credit worthiness. The allowance is estimated by management based on factors such as aging of the accounts receivable and anticipated collection of the consideration. Accounts are written off through bad debt expense when the Organization has exhausted all collection efforts and accounts are deemed impaired. The allowance for uncollectible accounts was $327,613 and $933,139 at December 31, 2018 and 2017, respectively.

### Assets Whose Use is Limited, Investment Risk and Investments

Assets held as operating reserves, resident deposits, and assets held under indenture agreements are classified as assets whose use is limited and are reported separately in the accompanying balance sheets. Investments and assets whose use is limited are reported in the accompanying balance sheets at fair value, based on quoted market prices as provided by a national exchange, excluding an alternative investment which is 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. Interest expense from borrowings to fund construction projects is 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 $2,086 and $4,467 at December 31, 2018 and 2017, 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 net assets with donor restrictions. 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 net assets with donor restrictions.

### 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 percent to 7.50 percent 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 policy requires payment of an entrance fee for admittance to an independent living residence under a type C fee-for-service contract. The Organization currently offers a traditional entrance fee, 50 percent guaranteed refund, and 90 percent guaranteed refund entrance fee option. The refundable portion of the traditional entrance fee is calculated based on a 60 month amortization period after applying a 10 percent administrative fee. After 60 months of occupancy, no refund is payable to the resident. The refundable portion of the 50 percent entrance fee is calculated based on a 30 month amortization period after applying a 10 percent administrative fee. After 30 months of occupancy, the refund payable to the resident is limited to 50 percent of the entrance fee. The 90 percent entrance fee guarantees a refund of the entrance fee paid less a 10 percent administrative fee. Contracts containing varying refund provisions no longer offered by the Organization to new residents remain in force.

The non-refundable portion of the entrance fees are accounted for as deferred revenue from entrance fees and are amortized into earned revenue using the straight-line method over the estimated remaining life of the residents over the contractual term of the contract. 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. The refundable portion of the entrance fees is not amortized into income and is reported as refundable entrance fees liability. Contractual refund obligations approximate $7,253,000 and $7,194,000 at December 31, 2018 and 2017, respectively.

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

### Deferred Financing Costs

Financing costs 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 in both 2018 and 2017. Accumulated amortization was $175,446 and $144,213 at December 31, 2018 and 2017, respectively.

### Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

*Net assets without donor restrictions* - net assets available for use in general operations and not subject to donor restrictions. All revenue not restricted by donors and donor restricted contributions whose restrictions are met in the same period in which they are received are accounted for in net assets without donor restrictions.

*Net assets with donor restrictions* - net assets subject to donor imposed restrictions. Some donor imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. All revenues restricted by donors as to either timing or purpose of the related expenditures or required to be maintained in perpetuity as a source of investment income are accounted for in net assets with donor restrictions. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions.

### 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

Net resident service revenues are reported at the amount that reflects the consideration the Organization expects to receive in exchange for the services provided. These amounts are due from residents or third-party payors and include variable consideration for retroactive adjustments, if any, under reimbursement programs. Performance obligations are determined based on the nature of the services provided. Net resident service revenues are recognized as performance obligations are satisfied.

Net resident service revenues are primarily comprised of the following revenue streams:

*Skilled nursing*: Skilled nursing revenues are primarily derived from providing nursing services to residents at a stated daily fee, net of any explicit and implicit price concessions. The Organization has determined that skilled nursing services are considered one performance obligation which is satisfied over time as services are provided. Therefore, skilled nursing revenues are recognized on a daily basis as services are rendered.

*Assisted living*: Assisted living revenues are primarily derived from providing housing and personal care services to residents at a stated monthly fee. The Organization has determined that the services included in the monthly fee have the same timing and pattern of transfer and are a series of distinct services that are considered one performance obligation which is satisfied over time as services are provided. Therefore, assisted living revenues are recognized on a month-to-month basis.

*Independent living*: Independent living revenues are primarily derived from providing housing and services to residents. The Organization has determined that the services included in the monthly fee have the same timing and pattern of transfer and are a series of distinct services that are considered one performance obligation which is satisfied over time as services are provided. Therefore, independent living monthly fees are recognized on a month-to-month basis.

The guaranteed refund component of entrance fees is not amortized to income and is classified as refundable entrance fees in the accompanying balance sheets.

*Other resident services*: Other resident services revenues include services such as housekeeping, laundry, transportation, medical supplies and other revenues from residents. The Organization has determined that other resident services revenues are considered one performance obligation which is satisfied over time as services are provided. Therefore, other resident services revenues are recognized on a daily basis as services are rendered.

Revenue from nonrefundable entrance fees received are recognized through amortization of the nonrefundable entrance fee using the straight-line method over annually adjusted estimated remaining life expectancies of the residents which during the contractual term of the contract approximates the period of time the goods and services under the agreements are expected to be transferred to residents. The unamortized portion is classified as deferred revenues from entrance fees on the balance sheets. Amortization of nonrefundable entrance fees included in net resident service revenues was $1,475,114 in 2018 and $1,174,008 in 2017.

The Organization receives revenue for services under third-party payor programs, including Medicare, Medicaid and other third-party payors. Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are included in the determination of the estimated transaction price for providing services. The Organization estimates the transaction price based on the terms of the contract and correspondence with the third-party payor and historical payment trends, and retroactive adjustments are recognized in future periods as final settlements are determined.

The Organization disaggregates revenue from contracts with customers by type of service and payor source as this depicts the nature, amount, timing and uncertainty of its revenue and cash flows as affected by economic factors. Net resident service revenues consist of the following for the years ended December 31, 2018 and 2017:

| | 2018 | | | | |
|---|---|---|---|---|---|
| | **Skilled Nursing** | **Assisted Living** | **Independent Living** | **Other Resident Services** | **Total** |
| Self-pay | $ 5,105,844 | $ 4,423,281 | $ 992,754 | $ 416,879 | $ 10,938,758 |
| Medicare | 9,219,049 | - | - | - | 9,219,049 |
| Medical Assistance | 5,104,256 | - | - | - | 5,104,256 |
| Commercial insurance | 928,499 | - | - | - | 928,499 |
| Amortization of nonrefundable entrance fees | - | - | 1,475,114 | - | 1,475,114 |
| Total | $ 20,357,648 | $ 4,423,281 | $ 2,467,868 | $ 416,879 | $ 27,665,676 |

| | 2017 | | | | |
|---|---|---|---|---|---|
| | **Skilled Nursing** | **Assisted Living** | **Independent Living** | **Other Resident Services** | **Total** |
| Self-pay | $ 4,072,842 | $ 4,239,763 | $ 1,049,880 | $ 447,347 | $ 9,809,832 |
| Medicare | 8,768,931 | - | - | - | 8,768,931 |
| Medical Assistance | 5,322,592 | - | - | - | 5,322,592 |
| Commercial insurance | 1,099,831 | - | - | - | 1,099,831 |
| Amortization of nonrefundable entrance fees | - | - | 1,174,008 | - | 1,174,008 |
| Total | $ 19,264,196 | $ 4,239,763 | $ 2,223,888 | $ 447,347 | $ 26,175,194 |

The Organization has agreements with third-party payors that provide for payments at amounts different from established rates. A summary of the payment arrangements with major third-party payors 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.

- 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.

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.

Payment terms and conditions for the Organization’s resident contracts vary by contract type and payor source, although terms generally include payment to be made within 30 days. Net resident service fee revenues for recurring and routine monthly services are generally billed monthly in advance. Net resident service fee revenues for ancillary services are generally billed monthly in arrears. Additionally, nonrefundable entrance fees are generally billed and collected in advance of move-in. Revenues collected from residents in advance are recognized as deferred revenue from entrance fees until the performance obligations are satisfied and are included in deferred revenues from entrance fees in the accompanying balance sheets.

### Advertising

The Organization expenses advertising costs as incurred. Advertising expense totaled approximately $724,000 and $1,035,000 for the years ended December 31, 2018 and 2017, respectively.

### Operating Loss

The statements of operations include the determination of operating loss. Changes in net assets without donor restrictions, which are excluded from operating loss, consistent with industry practice, include net unrealized (losses) gains on investments, net assets released from restrictions for capital purchases, 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

In 2018, the Organization adopted the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* using the full retrospective approach. ASU No. 2014-09 supersedes the revenue recognition requirements in *Topic 605, Revenue Recognition*, and most industry specific guidance. The core principle under ASU No. 2014-09 is that revenues are recognized 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. Additionally, ASU No. 2014-09 requires enhanced disclosures of revenue arrangements. Under the full retrospective approach, the guidance is applied to the first period presented, recognizing a cumulative effect of the adoption change as an adjustment to beginning net assets.

The adoption of ASU No. 2014-09 resulted in the write-off of deferred marketing costs previously capitalized on the balance sheets. In addition, advertising and marketing expense was increased for amounts previously capitalized during 2017. The impact of these changes on the financial statements in 2017 is as follows:

| | As Previously Reported | Adjustments | As Adjusted |
|---|---|---|---|
| Balance Sheet: | | | |
| Assets: | | | |
| Deferred marketing costs | $ 1,321,392 | $ (1,321,392) | $ - |
| Total assets | 83,018,311 | (1,321,392) | 81,696,919 |
| Net assets: | | | |
| Net assets without donor restriction | 29,359,720 | (1,321,392) | 28,038,328 |
| Total net assets | 33,104,314 | (1,321,392) | 31,782,922 |
| Total liabilities and net assets | 83,018,311 | (1,321,392) | 81,696,919 |
| Statement of Operations: | | | |
| Expenses: | | | |
| Advertising and marketing | 99,116 | 936,013 | 1,035,129 |
| Total expenses | 35,098,999 | 936,013 | 36,035,012 |
| Operating loss | (7,336,233) | (936,013) | (8,272,246) |
| Change in net assets without donor restriction | (6,259,746) | (936,013) | (7,195,759) |
| Statement of Changes in Net Assets: | | | |
| Change in net assets without donor restriction | (6,259,746) | (936,013) | (7,195,759) |
| Change in net assets | (5,759,035) | (936,013) | (6,695,048) |
| Net assets without donor restriction, beginning | 38,863,349 | (385,379) | 38,477,970 |
| Net assets without donor restriction, ending | 33,104,314 | (1,321,392) | 31,782,922 |
| Statement of Cash Flows: | | | |
| Change in net assets | (5,759,035) | (936,013) | (6,695,048) |
| Donor restricted contributions re-class | (42,625) | (570,325) | (612,950) |
| Net cash used in operating activities | (3,557,650) | (1,506,338) | (5,063,988) |
| Payment of deferred marketing costs | (936,013) | 936,013 | - |
| Net cash used in investing activities | (2,843,362) | 936,013 | (1,907,349) |
| Donor restricted contributions re-class | 42,625 | 570,325 | 612,950 |
| Net cash provided by financing activities | 7,542,712 | 570,325 | 8,113,037 |

**Presentation of Financial Statements**

In 2018, the Organization adopted the FASB's ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The Organization has adjusted the presentation of these financial statements accordingly. ASU No. 2016-14 has been applied retrospectively to all periods presented, except for the disclosures around liquidity and availability of resources and analysis of expenses by nature and function. These disclosures have been presented for 2018 only, as allowed by ASU No. 2016-14.

The new standard changes the following aspects of the financial statements:

- The unrestricted net assets class has been renamed net assets without donor restrictions;
- The temporarily and permanently restricted net asset classes have been combined into a single net asset class called net assets with donor restrictions;
- The financial statements include a disclosure about liquidity and availability of resources at December 31, 2018 (Note 3).
- The functional expense disclosure for 2018 includes expenses reported both by nature and function (Note 8).

**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.

**Reclassifications**

Certain items in the 2017 financial statements have been reclassified to conform to the 2018 financial statement presentation. The reclassifications had no effect on the change in net assets.

**Subsequent Events**

The Organization has evaluated subsequent events for recognition and disclosure through April 24, 2019, which is the date the financial statements were issued.

## 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, 2018 and 2017, by caption on the balance sheets:

| | 2018 | | | | |
|---|---|---|---|---|---|
| | **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 | $ 13,713,065 | $ 13,713,065 | $ 13,713,065 | $ - | $ - |
| Equity securities | 804,114 | 804,114 | 804,114 | - | - |
| Mutual funds | 1,589,805 | 1,589,805 | 1,589,805 | - | - |
| Fixed income securities | 227,860 | 227,860 | - | 227,860 | - |
| Other | 81,313 | 81,313 | - | 81,313 | - |
| Consolidated Fund | 18,814,811 | 18,814,811 | 14,460,251 | 4,354,560 | - |
| Subtotal | 35,230,968 | 35,230,968 | 30,567,235 | 4,663,733 | - |
| Consolidated Fund alternative investment measured at NAV | 899,401 | | | | |
| Total | 36,130,369 | | | | |
| Funds held in trust by others | 1,928,796 | 1,928,796 | - | - | 1,928,796 |
| Total assets | $ 38,059,165 | $ 37,159,764 | $ 30,567,235 | $ 4,663,733 | $ 1,928,796 |
| **Disclosed at Fair Value** | | | | | |
| Cash and cash equivalents | $ 210,152 | $ 210,152 | $ 210,152 | $ - | $ - |
| Long-term debt | $ 34,110,000 | $ 33,649,409 | $ 33,649,409 | $ 33,649,409 | $ - |

| | 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 investment 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 |
| **Disclosed at Fair Value** | | | | | |
| Cash and cash equivalents | $ 1,364,448 | $ 1,364,448 | $ 1,364,448 | $ - | $ - |
| Pledges receivable | $ 8,344 | $ 8,344 | $ - | $ 8,344 | $ - |
| Long-term debt | $ 20,985,000 | $ 21,155,922 | $ 21,155,922 | $ 21,155,922 | $ - |

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:

| | 2018 | 2017 |
|---|---|---|
| Investments | $ 17,798,942 | $ 15,427,781 |
| Assets whose use is limited: | | |
| Operating reserve | $ 4,714,016 | $ 4,438,360 |
| Resident deposits | 5,676,330 | 2,131,583 |
| Assets held under trust indenture (2012 Bonds): | | |
| Debt service reserve | 2,113,888 | 750,024 |
| Interest | 607,137 | 565,351 |
| Principal | 402,592 | 344,516 |
| Replacement reserves | 43,767 | 43,200 |
| Assets held under trust indenture (2018 Bonds): | | |
| Interest | 1,026,284 | - |
| Construction | 3,746,260 | - |
| Cost of issuance | 1,153 | - |
| | 18,331,427 | 8,273,034 |
| Less current portion | (1,636,384) | (895,742) |
| Assets whose use is limited, net | $ 16,695,043 | $ 7,377,292 |

For assets falling within the Level 3 in the fair value hierarchy, the activity recognized during the years ended December 31, 2018 and 2017 is as follows:

| | Funds Held in Trust by Others |
|---|---|
| Balance as of December 31, 2016 | $ 1,939,999 |
| Change in value | 44,791 |
| Balance as of December 31, 2017 | 1,984,790 |
| Change in value | (55,994) |
| Balance as of December 31, 2018 | $ 1,928,796 |

The change in Level 3 assets is recorded in the statements of operations and changes in net assets as an increase or decrease in net assets with donor restrictions.

Certain investments are pooled with related organizations and are referred to as "Consolidated Fund" investments. Approximately 27.34 percent and 24.17 percent of the pooled investments are attributable to the Organization as of December 31, 2018 and 2017, 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, 2018 and 2017:

| | 2018 | | | |
|---|---|---|---|---|
| | **Carrying Value** | **Fair Value** | **Level 1** | **Level 2** |
| Consolidated Fund: | | | | |
| Cash and cash equivalents | $ 1,292,196 | $ 1,292,196 | $ 1,292,196 | $ - |
| Equity securities: | | | | |
| Consumer discretionary | 2,641,761 | 2,641,761 | 2,641,761 | - |
| Consumer staples | 565,613 | 565,613 | 565,613 | - |
| Energy | 884,748 | 884,748 | 884,748 | - |
| Financial | 893,062 | 893,062 | 893,062 | - |
| Health care | 1,206,188 | 1,206,188 | 1,206,188 | - |
| Industrials | 661,785 | 661,785 | 661,785 | - |
| Information technology | 985,792 | 985,792 | 985,792 | - |
| Materials | 198,049 | 198,049 | 198,049 | - |
| Real estate | 429,975 | 429,975 | 429,975 | - |
| Utilities | 319,716 | 319,716 | 319,716 | - |
| Other | 325,346 | 325,346 | 325,346 | - |
| Mutual funds: | | | | |
| Fixed income | 1,433,359 | 1,433,359 | 1,433,359 | - |
| Equity | 2,622,661 | 2,622,661 | 2,622,661 | - |
| Fixed income securities: | | | | |
| Corporate bonds | 2,407,214 | 2,407,214 | - | 2,407,214 |
| U.S. Government and agency bonds | 1,947,346 | 1,947,346 | - | 1,947,346 |
| Subtotal | 18,814,811 | $ 18,814,811 | $ 14,460,251 | $ 4,354,560 |
| Alternative investment measured at NAV | 899,401 | | | |
| Total | $ 19,714,212 | | | |

| | 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 | - |
| Real estate | 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 investment measured at NAV | 775,962 | | | |
| Total | $ 19,308,787 | | | |

**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 investment is comprised of a hedge fund. The Organization measures the fair value of the alternative investment 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. The Organization’s share of the of the Consolidated Fund's alternative investments as of December 31, 2018 and 2017 was $899,401 and $775,962, respectively. The investment strategy for Ironwood Institutional Multi-Strategy Fund (the "Fund") is capital appreciation with limited variability of returns. The 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. There were no unfunded commitments as of December 31, 2018 or 2017 and there is a monthly or quarterly redemption notice of 15 - 120 days.

Pledges receivable are valued based on the original pledge amounts, adjusted by a discount rate that a market participant would demand and an evaluation for uncollectible pledges.

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 long-term debt is based on current rates offered for similar issues with similar terms and maturities, or estimated based using a discount rate a market participant would demand.

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 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. 158 and 92 individual securities had unrealized losses at December 31, 2018 and 2017, respectively. Management believes that these holding losses are not permanently impaired as they reflect general market conditions instead of a permanent decline in value.

| | 2018 - 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 | $ 3,333,973 | $ (313,838) | $ 146,751 | $ (93,397) | $ 3,480,724 | $ (407,235) |
| Mutual funds | - | - | 1,754,772 | (348,844) | 1,784,772 | (348,844) |
| Fixed income securities | 1,903,401 | (58,533) | 1,658,288 | (51,164) | 3,561,689 | (109,697) |
| | $ 5,237,374 | $ (372,371) | $ 3,559,811 | $ (493,405) | $ 8,827,185 | $ (865,776) |
| | **2017 - Consolidated Fund** | | | | | |
| 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) |

### 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 percent 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, 2018 is as follows:

| | |
|---|---|
| Total operating expenses for fiscal year ended December 31, 2018 | $ 36,824,958 |
| Less: | |
| Depreciation | (4,162,713) |
| Interest | (1,235,470) |
| Adjusted operating expense | $ 31,426,775 |
| Funding requirement (15% of operating expenses) | $ 4,714,016 |

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 percent of the facility's net operating expenses.

### 3. Liquidity and Availability of Resources

The following table reflects the Organization's financial assets available for general expenditure within one year at December 31, 2018. Financial assets are considered unavailable when illiquid or not convertible to cash within one year. Unavailable financial assets consist of: resident deposits, assets whose use is limited, debt service reserves, operating reserves, and donor restricted funds.

| | |
|---|---|
| Financial assets: | |
| Cash and cash equivalents | $ 210,152 |
| Investments | 17,798,942 |
| Accounts receivable, net | 1,935,675 |
| Total financial assets | $ 19,944,769 |

As part of the Organization's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. The Organization invests cash in excess of daily requirements in short-term investments. Certain of the donor purpose restricted funds may be utilized as the restrictions are satisfied. As stated in Note 2, the Organization designated a portion of its investments as an operating reserve to comply with the requirements of the Maryland Department of Aging Reserve Requirements and thus they are not included in the schedule above. Although the Organization does not intend to utilize the operating reserve for general expenditures as part of its annual budget and approval process, amounts designated as operating reserves could be made available as necessary. The operating reserves are included in assets whose use is limited on the balance sheets and do not have third party restrictions or limitations on the withdrawal and subsequent liquidation of such funds.

### 4. Property and Equipment

A summary of property and equipment and the related accumulated depreciation is as follows at December 31, 2018 and 2017:

| | 2018 | 2017 |
|---|---|---|
| Land | $ 3,255,295 | $ 3,255,295 |
| Land improvements | 264,541 | 264,541 |
| Buildings and building improvements | 79,422,581 | 75,781,132 |
| Furniture and equipment | 10,066,388 | 9,456,706 |
| Construction in progress | 5,916,469 | 4,729,412 |
| | 98,925,274 | 93,487,086 |
| Less accumulated depreciation | (45,217,875) | (41,055,161) |
| | $ 53,707,399 | $ 52,431,925 |

Construction in progress at December 31, 2018 consists of initial project development and construction costs for an expansion and repositioning project 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 $5,703,688 in resident deposits as of December 31, 2018 primarily related to the project. A construction contract exists in the amount of approximately $54,800,000 of which $612,000 was completed as of December 31, 2018.

## 5. Long-Term Debt

Long-term debt, net consists of the following as of December 31, 2018 and 2017:

| | 2018 | 2017 |
|---|---|---|
| Series 2018A Fixed Rate Economic Development Revenue Bonds, at 6.50 percent, payable in monthly installments of interest only through February 2022, and then monthly principal and interest payments begin through November 2048 to satisfy annual debt service requirements. | $ 2,705,000 | $ - |
| Series 2018B Adjustable Rate Economic Development Revenue Bonds, at 5.66 percent, payable in monthly installments of interest only through February 2022, and then monthly principal and interest payments begin through February 2049 to satisfy annual debt service requirements. The 2018B Bonds interest rate adjusts February 2028 as defined in the debt agreements. | 2,215,000 | - |
| Series 2018C Floating Rate Economic Development Revenue Bonds, payable in monthly installments of interest only with a final payment of principal due February 2029. Interest is payable at a variable interest rate of 75 percent of LIBOR plus 2.45 percent (4.23 percent at December 31, 2018). | 6,145,000 | - |
| Series 2018D Adjustable Rate Economic Development Revenue Bonds, at 5.66 percent, payable in monthly installments of interest only through February 2022, and then monthly principal and interest payments begin through February 2049 to satisfy annual debt service requirements. The 2018B Bonds interest rate adjusts in February 2028 as defined in the debt agreements. | 2,435,000 | - |
| 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 percent to 7.23 percent. | 12,250,000 | 12,455,000 |
| 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 percent to 5.61 percent through January 2022. Beginning in February 2022 through maturity, the interest rate will become a variable rate. | 8,360,000 | 8,530,000 |
| | 34,110,000 | 20,985,000 |
| Less: current portion | (400,000) | (375,000) |
| Long-term debt, excluding deferred financing costs | 33,710,000 | 20,610,000 |
| Deferred financing costs, net of accumulated amortization | (2,475,148) | (749,581) |
| Long-term debt, net | $ 31,234,852 | $ 19,860,419 |

The Series 2018 Bonds are draw down bonds to fund the construction project described in Note 4, with the total bond issuance being $87,500,000, consisting of $17,970,000 of Series 2018A, $13,690,000 of Series 2018B, $40,000,000 of Series 2018C, and $15,840,000 of Series 2018D.

As security for the payment of the bonds, the Organization has granted 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 and National Lutheran Home for the Aged, Inc. entered into support agreements guaranteeing the repayment of the bonds as additional security. The support agreements will terminate upon the achievement of certain financial performance targets as defined in the agreements.

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

| | |
|---|---|
| 2019 | $ 400,000 |
| 2020 | 425,000 |
| 2021 | 450,000 |
| 2022 | 645,000 |
| 2023 | 1,235,000 |
| Thereafter | 30,955,000 |
| | $ 34,110,000 |

Interest expense totaled $1,235,470 in 2018 and $1,264,682 in 2017, net of capitalized interest of $88,238 in 2018.

## 6. Net Assets

Net assets presentation on the balance sheets with expanded disclosure for the amount and purpose of designations is as follows:

| | 2018 | 2017 |
|---|---|---|
| Net assets: | | |
| Without donor restrictions: | | |
| Undesignated | $ 14,386,012 | $ 23,599,968 |
| Maryland Department of Aging reserve requirements | 4,714,016 | 4,438,360 |
| | 19,100,028 | 28,038,328 |
| With donor restrictions: | | |
| Purpose restricted for: | | |
| Operations | 125,149 | 610,624 |
| Capital projects | - | 464,223 |
| Charitable remainder trusts | 394,268 | 421,038 |
| Perpetual trusts | 1,534,528 | 1,606,377 |
| Restricted in perpetuity | 799,483 | 642,332 |
| | 2,853,428 | 3,744,594 |
| Total net assets | $ 21,953,456 | $ 31,782,922 |

During 2018 and 2017, net assets of $441,972 and $157,030, respectively, were released from donor restrictions for operations by incurring expenses satisfying the restricted purposes. During 2018, net assets of $566,456 was released from donor restrictions relating to capital projects satisfying the restricted purposes.

Earnings from net assets restricted in perpetuity are available to support charitable and benevolent care provided by the Organization.

## 7. 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 $2,440,401 in 2018 and $2,441,043 in 2017.

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:

| | 2018 | 2017 |
|---|---|---|
| NLI | $ 20,869,988 | $ 15,668,148 |
| The Village at Orchard Ridge, Inc. | 143,628 | (212,513) |
| The Legacy at North Augusta, Inc. | (290,511) | (156,248) |
| myPotential Virginia, LLC | (88,658) | (40,244) |
| myPotential Maryland, LLC | (19,337) | (9,147) |
| myPotential Clinic-Rockville, LLC | (11,254) | 6,000 |
| National Lutheran Home for the Aged, Inc. | 1,398 | 2,134 |
| | $ 20,605,254 | $ 15,258,130 |

## 8. Expenses by Nature and Function

The Organization's expenses for resident services (including skilled nursing, assisted living, independent living, and other resident services) and general and administrative are as follows for the year ending December 31, 2018:

| | Resident Services | General and Administrative | Total |
|---|---|---|---|
| Salaries and wages | $ 13,726,593 | $ 906,890 | $ 14,633,483 |
| Employee benefits and payroll taxes | 3,339,812 | 228,131 | 3,567,943 |
| Professional fees | 1,118,338 | 172,699 | 1,291,037 |
| Ancillary and medical | 3,602,751 | - | 3,602,751 |
| Supplies | 351,137 | 301,793 | 652,930 |
| Food services | 1,048,965 | 22,894 | 1,071,859 |
| Utilities | 1,118,999 | 22,401 | 1,141,400 |
| Depreciation | 4,162,713 | - | 4,162,713 |
| Interest | 1,235,470 | - | 1,235,470 |
| Insurance | 58,700 | - | 58,700 |
| Real estate taxes | 273,714 | - | 273,714 |
| Repairs and maintenance | 447,810 | 89,114 | 536,924 |
| Advertising and marketing | 176,624 | 547,786 | 724,410 |
| Licenses, dues and subscriptions | 460,151 | 157,402 | 617,553 |
| Other operating expenses | 300,703 | 59,099 | 359,802 |
| Bad debt expense | 510,341 | - | 510,341 |
| Management fee | - | 2,440,001 | 2,440,001 |
| Annuities | (56,073) | - | (56,073) |
| Total | $ 31,876,748 | $ 4,948,210 | $ 36,824,958 |

The financial statements report certain expense categories that are attributable to more than one health care or support function. Therefore these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function are allocated to the functions based on square footage basis.

In 2017, $30,979,364 of expenses related to resident services and $5,055,648 related to general and administrative. Fundraising expenses are incurred through NLI.

## 9. Pension Plan

The Organization has a 403(b) defined contribution plan. The Organization contributes 2 percent of the eligible employees' salaries and matches 50 percent of each employee's contribution up to 8 percent after 90 days of service for a maximum contribution of 6 percent. All participating employees' contributions are 100 percent vested and employer contributions are vested at 20 percent per year to 100 percent after 5 years. Employer contributions totaled $523,477 in 2018 and $475,820 in 2017.

## 10. 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 $3,357,000 in 2018 and $5,020,000 in 2017, including approximately $3,105,000 in 2018 and $4,495,000 in 2017, respectively, related to the Medicaid program.

## 11. 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 Medicaid, Medicare and various commercial insurance companies. The Organization maintains reserves for potential credit losses and such losses have historically been within management's expectations.

## 12. 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.

## 13. 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.