National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Consolidated Financial Statements and
Supplementary Information

December 31, 2016 and 2015

BAKER TILLY

Candor. Insight. Results.

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Table of Contents
December 31, 2016 and 2015

BAKER TILLY

Independent Auditors' Report

Board of Trustees
National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of National Lutheran, Inc. d/b/a National Lutheran Communities & Services, a non-profit organization, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of National Lutheran, Inc. d/b/a National Lutheran Communities & Services as of December 31, 2016 and 2015, and the results of their 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.

Change in Reporting Entity

As discussed in Note 1 to the consolidated financial statements, National Lutheran, Inc. became the new parent of the system doing business as National Lutheran Communities and Services, effective January 1, 2016, replacing the former parent National Lutheran Home for the Aged, Inc., which has become a supporting organization to the system. Our opinion is not modified with respect to that matter.

Report on Consolidating Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating schedules on pages 30 through 33 are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and changes in net assets of the individual companies, and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Baker Tilly Virchow Krause, LLP

Wyomissing, Pennsylvania
April 6, 2017

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Consolidated Balance Sheets
December 31, 2016 and 2015

	2016	2015
Assets		
Current Assets		
Cash and cash equivalents	$ 5,928,510	$ 1,287,931
Accounts receivable, net	2,391,939	1,939,094
Inventory	296,433	311,109
Prepaid expenses and other assets	1,144,365	1,236,596
Current portion of pledges receivable	105,312	115,353
Current portion of assets whose use is limited	6,214,672	7,729,351
Total current assets	16,081,231	12,619,434
Assets Whose Use is Limited, Net	20,184,494	18,173,416
Investments	84,747,783	93,493,384
Property and Equipment, Net	244,259,558	222,318,823
Funds Held in Trust by Others	1,939,999	2,125,292
Pledges Receivable, Net	38,073	75,465
Deferred Marketing Costs, Net	8,461,649	8,013,374
Total assets	$ 375,712,787	$ 356,819,188

	2016	2015
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	$ 1,384,144	$ 1,903,212
Accounts payable, construction	1,499,819	3,599,764
Accrued interest	3,774,853	3,084,587
Accrued expenses	2,910,230	2,465,278
Current portion of long-term debt	5,065,000	1,045,000
Current portion of annuities payable	38,885	38,135
Total current liabilities	14,672,931	12,135,976
Resident Deposits	2,076,230	2,258,288
Monthly Fees Paid in Advance	-	53,437
Deferred Revenue from Entrance Fees	36,765,521	37,685,902
Refundable Entrance Fees	33,536,332	28,344,309
Long-Term Debt, Net	134,558,005	110,011,816
Annuities Payable, Net	219,431	228,832
Total liabilities	221,828,450	190,718,560
Net Assets		
Unrestricted	148,943,402	161,387,088
Temporarily restricted	2,586,671	2,725,473
Permanently restricted	2,354,264	1,988,067
Total net assets	153,884,337	166,100,628
Total liabilities and net assets	$ 375,712,787	$ 356,819,188

See notes to consolidated financial statements

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Consolidated Statements of Operations
Years Ended December 31, 2016 and 2015

	2016	2015
Unrestricted Revenues		
Net resident service revenues	$ 46,194,372	$ 42,473,391
Contributions	139,874	177,180
Management fee	500,000	539,955
Interest and dividends	1,976,311	2,812,988
Realized gains	550,800	2,294,372
Other income	463,213	572,653
Net assets released from restriction - operations	50,122	-
Total unrestricted revenues	49,874,692	48,870,539
Expenses		
Salaries and wages	25,535,465	23,577,918
Employee benefits and payroll taxes	6,134,611	5,608,220
Medicare services	3,325,994	3,542,961
Other resident care	832,901	737,318
Professional fees	1,377,535	3,023,783
Supplies	1,085,362	1,140,099
Food services	1,988,624	2,035,069
Utilities and other occupancy	3,348,071	2,907,414
Depreciation and amortization	10,367,659	9,789,679
Interest, net of amounts capitalized	5,103,681	5,319,389
Insurance and licenses	595,099	587,244
Minor equipment	284,100	238,960
Repairs and maintenance	1,214,470	1,482,171
Advertising and recruitment	735,563	589,815
Information technology	1,241,316	1,245,441
Legal and accounting	235,932	227,841
Dues and subscriptions	1,334,552	1,205,597
Miscellaneous	1,304,831	1,665,377
Bad debt expense	762,126	636,440
Annuities	30,192	20,545
Loss on sale or disposal of assets	-	152,100
Total expenses	66,838,084	65,733,381
Operating loss	(16,963,392)	(16,862,842)
Net Assets Released from Restriction - Capital Purchases	269,135	-
Unrealized Gains (Losses)	4,250,571	(7,037,627)
Change in unrestricted net assets	$ (12,443,686)	$ (23,900,469)

See notes to consolidated financial statements

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Consolidated Statements of Changes in Net Assets
Years Ended December 31, 2016 and 2015

	2016	2015
Unrestricted Net Assets		
Operating loss	$ (16,963,392)	$ (16,862,842)
Net assets released from restriction - capital purchases	269,135	-
Unrealized gains (losses)	4,250,571	(7,037,627)
Change in unrestricted net assets	(12,443,686)	(23,900,469)
Temporarily Restricted Net Assets		
Contributions	474,057	1,373,144
Contributions of funds held in trust by others	-	271,783
Change in value of funds held in trust by others	(21,819)	(10,832)
Distributions of funds held in trust by others	(271,783)	-
Net assets released from restriction - operations	(50,122)	-
Net assets released from restriction - capital purchases	(269,135)	-
Change in temporarily restricted net assets	(138,802)	1,634,095
Permanently Restricted Net Assets		
Contributions	332,898	78,745
Contributions of funds held in trust by others	128,281	-
Change in value of funds held in trust by others	(19,972)	23,600
Uncollectible pledges receivable	(75,010)	-
Change in permanently restricted net assets	366,197	102,345
Change in net assets	(12,216,291)	(22,164,029)
Net Assets, Beginning	166,100,628	188,264,657
Net Assets, Ending	$ 153,884,337	$ 166,100,628

See notes to consolidated financial statements

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Consolidated Statements of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities		
Change in net assets	$ (12,216,291)	$ (22,164,029)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	10,364,337	9,789,679
Amortization of deferred financing fees	130,236	193,293
Amortization of entrance fees	(5,453,614)	(5,065,694)
Proceeds from non-refundable entrance fees, turnover units	3,721,406	5,436,107
Realized gains	(550,800)	(2,294,372)
Unrealized (gains) losses	(4,250,571)	7,037,627
Contributions permanently restricted by donor	(332,898)	(78,745)
Change in allowance for uncollectible accounts receivable	25,715	(76,347)
Change in value of funds held in trusts by others	41,791	(284,551)
Contributions of funds held in trust by others	(128,281)	-
Change in annuities payable, net	(8,651)	(17,702)
Loss on sale or disposal of assets	-	152,100
Changes in assets and liabilities:		
Accounts receivable	(478,560)	308,422
Inventory, prepaid expenses and other assets	106,907	(493,098)
Accounts payable and accrued expenses	616,150	1,057,352
Monthly fees paid in advance	(53,437)	10,704
Resident deposits	(182,058)	(779,575)
Net cash used in operating activities	(8,648,619)	(7,268,829)
Cash Flows from Investing Activities		
Net proceeds from sales of investments and assets whose use is limited	13,050,573	15,725,527
Purchases of property and equipment	(33,539,024)	(34,608,161)
Purchases of marketing costs	(1,244,011)	(864,067)
Net cash used in investing activities	(21,732,462)	(19,746,701)

See notes to consolidated financial statements

Consolidated Statements of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Cash Flows from Financing Activities		
Proceeds from issuance of long-term debt	$ 29,935,000	$ 24,900,000
Principal payments on long-term debt	(1,045,000)	(7,650,000)
Proceeds from entrance fees, new units	4,852,660	8,427,083
Proceeds from refundable entrance fees, turnover units	2,428,558	976,214
Refunds of entrance fees	(1,277,368)	(2,454,072)
Contributions permanently restricted by donor	332,898	78,745
Cash received from funds held in trust by others	271,783	-
Change in pledges receivable, net	47,433	39,621
Cash paid for financing fees	(524,304)	(444,738)
Net cash provided by financing activities	35,021,660	23,872,853
Net change in cash and cash equivalents	4,640,579	(3,142,677)
Cash and Cash Equivalents, Beginning	1,287,931	4,430,608
Cash and Cash Equivalents, Ending	$ 5,928,510	$ 1,287,931
Supplementary Cash Flows Information		
Interest paid, net of interest capitalized of $2,789,364 in 2016 and $1,169,708 in 2015	$ 4,283,179	$ 4,634,446

Supplementary Disclosure of Noncash Investing and Financing Activities

Property, plant, and equipment additions in the amount of $1,499,819 and $3,599,764 are included in accounts payable, construction at December 31, 2016 and 2015, respectively.

See notes to consolidated financial statements

1. Organization and Summary of Significant Accounting Policies

Organization

National Lutheran, Inc. ("NLI"), a Maryland not-for-profit corporation, effective January 1, 2016 became the parent corporation of a system doing business as National Lutheran Communities and Services ("NLCS"). National Lutheran Home for the Aged, Inc. ("NLHA") is a Maryland not-for-profit corporation that prior to January 1, 2016 had been the parent corporation of NLCS. NLHA amended its bylaws and is now a supporting organization to NLCS and its Board Members are elected by NLI. All operating activities and employees of NLHA were transferred from NLHA to NLI. The change had no effect on the prior period consolidated financial statements.

NLI is 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. As the members of NLCS, these synods share in the control, support, and services of NLCS.

NLI provides management and support services and is the sole member or parent of the following affiliates, in addition to NLHA:

The Village at Rockville, Inc. ("TVAR"), (TVAR changed its name effective January 1, 2016 and had previously operated as National Lutheran Home and Village at Rockville, Inc.) a not-for-profit corporation originally incorporated in the District of Columbia, operates a retirement community in Rockville, Maryland including 144 independent living units, 50 assisted living units, and a 160 skilled nursing beds.

The Village at Orchard Ridge, Inc. ("TVOR"), a Virginia not-for-profit corporation, operates a continuing care retirement community in Winchester, Virginia. The community opened during February 2013 and consists of 196 independent living units, 25 independent living rental units, 10 skilled nursing units and 18 assisted living units. The community completed a Phase II expansion project in December 2016 which resulted in adding an additional 104 independent living units (13 of which were occupied during 2016), and additional dining space, a Health & Wellness Center and 11 additional skilled nursing units.

The Legacy at North Augusta, Inc. ("TLNA"), a Virginia not-for-profit corporation, operates independent and assisted living services in Staunton, Virginia and offers 104 dual-purpose assisted living and independent living units.

The Village at Crystal Spring, Inc. ("TVCS"), a Maryland not-for-profit corporation, was formed to acquire and develop property located in Annapolis, Maryland as a continuing care retirement community. TVCS has entered into land purchase option and developer agreements related to the project. The development is in its planning and development stages and TVCS had no operations during 2016 or 2015 as all initial costs are being paid by NLI. TVCS is awaiting various approvals to begin construction. During February 2017, TVCS announced its name would change to the Village at Providence Point.

Community Services, LLC was incorporated as a Maryland limited liability corporation in 2016 to own and manage community clinics and home health organizations for the benefit of seniors. Effective November 18, 2016 Community Services, LLC is the sole member of the following corporations whose sole member had previously been NLI:

myPotential Maryland, LLC ("myPotential MD") is a Maryland limited liability corporation which operates a home care business for seniors in Maryland.

myPotential Virginia, LLC ("myPotential VA") is a Virginia limited liability corporation which operates a home care business for seniors in Virginia.

myPotential Clinic-Rockville, LLC was incorporated in 2016 as a Maryland limited liability corporation and plans to begin operations in 2017 to operate a community clinic for the benefit of seniors.

Principles of Consolidation

The consolidated financial statements include the accounts of NLI and its subsidiaries, NLHA, TVAR, TVOR, TLNA, TVCS, and Community Services, LLC and its subsidiaries, myPotential MD, myPotential VA, and myPotential Clinic-Rockville, LLC, after elimination of all significant interrelated balances and transactions, and are collectively referred to as the "Organization."

Use of Estimates

The preparation of consolidated 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 consolidated 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. The provision 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 $696,178 and $670,462 at December 31, 2016 and 2015, respectively. Losses are charged against the allowance for uncollectible accounts receivable when management believes the uncollectibility of a receivable is confirmed.

Inventory

Inventory is stated at the lower of cost (determined on a first-in, first-out basis) or market and consists of supplies for the various operating departments.

Assets Whose Use is Limited 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 consolidated balance sheet. 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 consolidated balance sheet at the fair value, based on quoted market prices as provided by a national exchange. 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 consolidated balance sheet 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 consolidated balance sheet 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 improvements and land improvements. Expenditures that extend the useful lives of the asset or significantly increase their capacity are capitalized. The Organization follows the policy of capitalizing interest as a component of the cost of the asset acquired or constructed.

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 $15,932 and $21,201 at December 31, 2016 and 2015, respectively.

Deferred Marketing Costs

Costs associated with marketing new independent living units until substantially occupied or one year after completion are being accumulated as costs of acquiring initial continuing care contracts. The costs begin amortizing as the independent living units are substantially occupied and are amortized over the weighted average life expectancy of the initial resident population. Capitalized costs totaled $10,853,981 with accumulated amortization of $2,392,332 at December 31, 2016. Total capitalized costs were $9,609,968 with accumulated amortization of $1,596,596 at December 31, 2015. Amortization expense totaled $795,736 in 2016 and $761,344 in 2015.

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 contributions in the consolidated statement of operations. The Organization uses published mortality tables adopted by the United States Internal Revenue Service (“IRS”) and an assumed discount rate of approximately 0.05% to 7.50% to determine the present value of the actuarially determined liability.

Entrance Fees

TVAR’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 $6,900,000 and $7,100,000 at December 31, 2016 and 2015, respectively.

TVAR also has a rental agreement requiring no entrance fee.

TVOR's Independent Living admissions policy requires the payment of an entrance fee for admittance. The entrance fee is a type C fee-for-service contract. The Organization has a traditional non-refundable entrance fee with a refund payable on an initial deduction of 10% of the initial fee and less a reduction of 5% per month for the first eighteen months of residency. The Organization also has 100% and 50% refundable entrance fee contracts. The non-refundable portions of the contracts are accounted for as deferred revenue from entrance fees and are 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. The refundable portion of the contracts is not amortized into income and is reported as a refundable entrance fee liability. Contractual refund obligations approximate $38,500,000 and $32,800,000 at December 31, 2016 and 2015, respectively.

TVOR also has a rental agreement requiring no entrance fee, but a one-time community fee of $2,500.

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. These costs are reported in the consolidated balance sheets as a reduction of long-term debt and amortized over the life of the debt using the straight-line method, which approximates the effective interest method. Total deferred financing costs were $6,653,575 with an accumulated amortization of $641,580 at December 31, 2016. Total deferred financing costs were $6,126,271 with an accumulated amortization of $438,087 at December 31, 2015. Amortization of deferred financing costs included in interest expense totaled $130,236 during 2016 and $193,294 during 2015. Deferred financing costs of $70,257 were capitalized to construction in progress during 2016.

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 permanently 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 consolidated 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. Absent explicit donor stipulations about how long those long-lived assets must be maintained, 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 consolidated 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 at TVAR and TVOR 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 12% of the Organization's net resident service revenues in both 2016 and 2015 were derived from the Medical Assistance program.

The Maryland Department of Health and Mental Hygiene has transitioned from a retrospective, cost-based system to a prospective Case Mix RUGs based payment system effective January 1, 2015. There will be a "hold harmless" provision that will not allow providers' rates to go below the 2012 cost based rate as adjusted for inflation.

- 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 21% and 23% of the Organization's net resident service revenues in 2016 and 2015, 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.

At TLNA, each resident executes a Residency Agreement which includes a one-time fee of $1,000, payable at the time of move-in. The fee is non-refundable except that such a fee would be refundable if a resident gives notice of its intention to terminate the Residency Agreement within 30 days of moving into the residential unit. Monthly service fees and charges, including the room rate are payable in advance.

Advertising

The Organization expenses advertising costs as incurred. Advertising expense totaled approximately $558,000 and $467,000 for the years ended December 31, 2016 and 2015, respectively.

Operating Loss

The consolidated 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 (losses) 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

NLI, NLHA, TVAR, TVOR, TLNA, and TVCS are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code ("IRC") and are exempt from federal income taxes on related income pursuant to Section 509(a) of the IRC. Community Services, LLC and its subsidiaries are limited liability corporations and will be treated as disregarded entities for tax purposes with all activity flowing through to NLI.

The Organization accounts for uncertainty in income taxes by prescribing a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. Management determined that there were no tax uncertainties that met the recognition threshold in 2016 and 2015.

Recent Accounting Pronouncements

Fair Value Measurement

During May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)*. This ASU was issued to address the diversity in practice relating to how certain investments measured at net asset value are categorized in the fair value hierarchy. The amendments in ASU No. 2015-07 remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. ASU No. 2015-07 also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. The Organization adopted ASU No. 2015-07 for its year beginning January 1, 2016 and applied the guidance retrospectively. The adoption of ASU No. 2015-07 did not have a significant impact on the Organization, but expanded disclosures related to the investments.

Debt Issuance Costs

During April 2015, the FASB issued ASU No. 2015-03, *Interest-Imputation of Interest (Subtopic 835-30)*. ASU No. 2015-03 was issued to simplify the presentation of debt issuance costs presented in the consolidated balance sheets. Under ASU No. 2015-03, debt issuance costs are required to be reported as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. In addition, ASU No. 2015-03 clarified that the amortization of debt issuance costs are reported as interest expense in the consolidated statements of operations. The Organization adopted ASU No. 2015-03 for its year beginning January 1, 2016. The adoption did not have a material impact on the Organization's consolidated financial statements, but reclassified deferred financing costs as a reduction of long-term debt and amortization of deferred financing costs is now reflected as interest expense.

Revenue Recognition

During May 2014, FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. ASU No. 2014-09 establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. During August 2015, the FASB issued ASU No. 2015-14, which defers the effective date of ASU No. 2014-09. ASU No. 2014-09 is effective for fiscal years beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The Organization may elect to apply the guidance earlier, but no earlier than fiscal years beginning after December 15, 2016. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Organization is currently assessing the effect that ASU Nos. 2014-09 and 2015-14 will have on its consolidated financial statements.

Presentation of Consolidated 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 assessing the impact this standard will have on its consolidated financial statements.

Financial Instruments

The FASB issued ASU No. 2016-01, *Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities*. The new guidance is intended to enhance the reporting model for financial instruments to provide users of financial statements with information that is useful for decision making purposes. ASU 2016-01 requires changes in the fair value of equity investments, except those accounted for under the equity method of accounting, to be recognized in net income. It also contains certain disclosure requirements for financial instruments. ASU No. 2016-01 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted for fiscal years beginning after December 15, 2017. ASU No. 2016-14 is to be applied prospectively with transition provisions. The Organization is assessing the impact this standard will have on its consolidated financial statements.

Reclassifications

Certain items in the 2015 consolidated financial statements have been reclassified to conform to the 2016 consolidated financial statement presentation. These reclassifications had no effect on the change in net assets.

Subsequent Events

The Organization has evaluated subsequent events for recognition and disclosure through April 6, 2017, which is the date the consolidated financial statements were available to be 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, 2016 and 2015, by caption on the consolidated balance sheets:

	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	$ 27,070,616	$ 27,070,616	$ 27,070,616	$ -	$ -
Equity securities:					
Consumer discretionary	6,227,063	6,227,063	6,227,063	-	-
Consumer staples	1,755,392	1,755,392	1,755,392	-	-
Energy	3,859,156	3,859,156	3,859,156	-	-
Financial	6,587,613	6,587,613	6,587,613	-	-
Health care	5,256,163	5,256,163	5,256,163	-	-
Industrials	3,780,101	3,780,101	3,780,101	-	-
Information technology	4,326,080	4,326,080	4,326,080	-	-
Materials	1,639,260	1,639,260	1,639,260	-	-
Telecommunication	2,177,509	2,177,509	2,177,509	-	-
Utilities	1,215,759	1,215,759	1,215,759	-	-
Other	1,990,813	1,990,813	1,990,813	-	-
Mutual funds:					-
Equity	3,511,478	3,511,478	3,511,478	-	-
Fixed income	7,935,309	7,935,309	7,935,309	-	-
Other	9,369,360	9,369,360	9,369,360	-	-
Exchange-traded and closed-end funds	440,745	440,745	440,745	-	-
Other	82,541	82,541	-	82,541	-
Fixed income securities:					
Corporate bonds	11,151,414	11,151,414	-	11,151,414	-
U.S. government and agency bonds	7,897,281	7,897,281	-	7,897,281	-
	106,273,653	106,273,653	87,142,417	19,131,236	-
Alternative investments measured at NAV	4,873,296				
	111,146,949				
Funds held in trust by others	1,939,999	1,939,999	-	-	1,939,999
Total Assets	$ 113,086,948	$ 108,213,652	$ 87,142,417	$ 19,131,236	$ 1,939,999
Disclosed at Fair Value					
Cash and cash equivalents	$ 5,928,510	$ 5,928,510	$ 5,928,510	$ -	$ -
Long-term debt	$ 145,635,000	$ 146,219,000	$ -	$ 146,219,000	$ -

	2015				
	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	$ 28,335,326	$ 28,335,326	$ 28,335,326	$ -	$ -
Equity securities:					
Consumer discretionary	5,353,130	5,353,130	5,353,130	-	-
Consumer staples	1,910,851	1,910,851	1,910,851	-	-
Energy	1,688,313	1,688,313	1,688,313	-	-
Financial	10,126,394	10,126,394	10,126,394	-	-
Health care	5,718,397	5,718,397	5,718,397	-	-
Industrials	4,523,294	4,523,294	4,523,294	-	-
Information technology	6,479,835	6,479,835	6,479,835	-	-
Materials	2,194,574	2,194,574	2,194,574	-	-
Telecommunication	3,017,910	3,017,910	3,017,910	-	-
Utilities	771,927	771,927	771,927	-	-
Other	424,094	424,094	424,094	-	-
Mutual funds:					-
Equity	7,935,211	7,935,211	7,935,211	-	-
Fixed income	3,996,285	3,996,285	3,996,285	-	-
Other	9,635,982	9,635,982	9,635,982	-	-
Exchange-traded and closed-end funds	16,838	16,838	16,838	-	-
Other	83,241	83,241	-	83,241	-
Fixed income securities:					
Corporate bonds	11,921,981	11,921,981	-	11,921,981	-
U.S. government and agency bonds	10,389,339	10,389,339	-	10,389,339	-
	114,522,922	114,522,922	92,128,361	22,394,561	-
Alternative investments measured at NAV	4,873,229				
	119,396,151				
Funds held in trust by others	2,125,292	2,125,292	-	-	2,125,292
Total Assets	$ 121,521,443	$ 116,648,214	$ 92,128,361	$ 22,394,561	$ 2,125,292
Disclosed at Fair Value					
Cash and cash equivalents	$ 1,287,931	$ 1,287,931	$ 1,287,931	$ -	$ -
Long-term debt	$ 116,745,000	$ 118,650,000	$ -	$ 118,650,000	$ -

Investments and assets whose use is limited is 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 consolidated balance sheets.

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

	2016	2015
Investments	$ 84,747,783	$ 93,493,384
Assets whose use is limited:		
Refundable deposits	$ 2,196,638	$ 2,392,823
Operating reserve	4,512,901	4,385,746
Assets held under trust indentures	19,689,627	19,124,198
Total assets whose use is limited	26,399,166	25,902,767
Less current portion of assets whose use is limited	(6,214,672)	(7,729,351)
Assets whose use is limited, net	$ 20,184,494	$ 18,173,416

For assets falling within the Level 3 in the fair value hierarchy, the activity recognized during the years ended December 31, 2016 and 2015 is as follows:

	Funds Held in Trust by Others
Balance as of December 31, 2014	$ 1,840,741
Purchases/contributions	271,783
Change in value	12,768
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

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

	2016	2015
Temporarily restricted net assets	(293,602)	260,951
Permanently restricted net assets	108,309	23,600
	$ (185,293)	$ 284,551

Valuation Methodologies

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

Equity securities, mutual funds, and exchange-traded and closed-end funds are valued at closing price reported on the active market on which the individual securities are traded.

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

Alternative investments are comprised of hedge funds. The Organization measures the fair value of the alternative investments based on the net asset value per share (the “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 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 following table presents a list of the Organization's alternative investments as of December 31, 2016 and 2015:

Name of Fund	Fair Value December 31, 2016	Fair Value December 31, 2015	Investment Strategy	Unfunded Commitments	Redemption Frequency
Ironwood Institutional Multi Strategy Fund	$ 2,975,972	$ 2,939,234	(a)	N/A	Monthly/Quarterly 15-120 days
Skybridge Multi-Advisor Hedge Fund	1,897,324	1,933,995	(b)	N/A	Monthly/Quarterly 15-120 days
	$ 4,873,296	$ 4,873,229			

(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 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 at December 31, 2016 and 2015. 287 and 372 individual securities had unrealized losses at December 31, 2016 and 2015, respectively. Management believes that these holding losses are not permanently impaired as they reflect general market conditions instead of a permanent decline in value.

A summary of investments with fair values below cost consists of the following as of December 31:

	2016					
	Less than Twelve Months		More than Twelve Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed income securities	$ 3,580,776	$ (64,313)	$ 4,816,385	$ (82,948)	$ 8,397,161	$ (147,261)
Equity securities	4,794,551	(271,320)	3,754,014	(955,503)	8,548,565	(1,226,823)
Mutual funds	801,184	(33,363)	10,466,514	(888,032)	11,267,698	(921,395)
	$ 9,176,511	$ (368,996)	$ 19,036,913	$ (1,926,483)	$ 28,213,424	$ (2,295,479)
	2015					
Fixed income securities	$ 10,015,726	$ (233,568)	$ 2,272,662	$ (154,675)	$ 12,288,388	$ (388,243)
Equity securities	5,219,012	(993,654)	2,999,522	(1,095,345)	8,218,534	(2,088,999)
Mutual funds	11,728,687	(496,690)	4,835,159	(1,509,630)	16,563,846	(2,006,320)
	$ 26,963,425	$ (1,723,912)	$ 10,107,343	$ (2,759,650)	$ 37,070,768	$ (4,483,562)

Maryland Department of Aging Reserve Requirements

In accordance with Maryland law governing continuing care retirement communities, TVAR 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, 2016 is as follows:

TVAR's total operating expenses for fiscal year ended December 31, 2015	$ 35,385,662
Less:	
Depreciation	(3,993,473)
Interest	(1,306,183)
Adjusted operating expense	$ 30,086,006
Funding requirement (15% of operating expenses)	$ 4,512,901

TVAR 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 TVAR'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, 2016 and 2015:

	2016	2015
Land	$ 19,050,712	$ 19,050,712
Land improvements	11,427,056	8,130,732
Buildings and building improvements	231,798,188	181,775,647
Furniture and equipment	21,930,275	19,536,124
Construction in progress	16,195,816	40,440,294
	300,402,047	268,933,509
Less accumulated depreciation	(56,142,489)	(46,614,686)
	$ 244,259,558	$ 222,318,823

Depreciation expense totaled $9,568,601 and $9,028,335 for the years ended December 31, 2016 and 2015, respectively.

Construction in progress consists primarily of the following:

Initial project development costs for a future planned expansion and repositioning project at TVAR. The campus is currently in the process of expanding the number of available independent living units by adding 132 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. No construction commitments exist as of December 31, 2016.

Initial planning costs for future expansion/renovation projects at TLNA. There are no material commitments on these projects at December 31, 2016.

Planning and pre-development costs for TVCS of approximately $12,000,000. TVCS has development agreements in place and during 2016 executed land purchase agreements subject to various approvals and timetables. There are no material contract commitments at December 31, 2016.

4. Long-Term Debt

Long-term debt consists of the following as of December 31, 2016 and 2015:

	2016	2015
Series 2011 Residential Care Facility Revenue Bonds (TLNA), payable in monthly installments to satisfy annual debt service requirements through July 2045. Interest is payable at a fixed rate of 5.25% through January 1, 2018, and then 6.625% through June 2021. Prior to January 1, 2016 the interest rate was 5.00%. Beginning in July 2021, the interest rate will become a variable rate through maturity.	$ 16,775,000	$ 17,000,000
Series 2011A Residential Care Facility Revenue Bonds (TVOR), payable in monthly installments to satisfy annual debt service requirements through July 2045. Interest is payable at fixed rates ranging from 6.46% to 7.80%.	39,680,000	40,000,000
Series 2011B Residential Care Facility Revenue Bonds (TVOR), payable in monthly installments to satisfy annual debt service requirements through July 2041. Interest is payable at fixed rates ranging from 4.63% to 5.66% through June 2021. Beginning in July 2021 through maturity, the interest rate will become a variable rate.	-	160,000
Series 2014A Residential Care Facility Revenue Bonds (TVOR), payable in monthly installments to satisfy annual debt service requirements through July 2044. Interest is payable at fixed rates of 5.64% to 6.83%	36,935,000	19,000,000
Series 2014B Residential Care Facility Revenue Bonds (TVOR), payable in monthly installments to satisfy annual debt service requirements through July 2024. Interest is payable at fixed rates of 4.43% to 5.04%. Beginning in July 2024 through maturity, the interest rate will be subject to a reset rate.	12,000,000	1,500,000
Series 2014C Residential Care Facility Revenue Bonds (TVOR), payable in monthly installments to satisfy annual debt service requirements through July 2024. Interest is payable at a monthly variable rate (3.45% at December 31, 2016).	8,000,000	8,000,000

	2016	2015
Series 2014D Residential Care Facility Revenue Bonds (TVOR), payable in monthly installments to satisfy annual debt service requirements through July 2044. Interest is payable at an initial fixed rates of 4.76% to 5.32%. Beginning in July 2024 through maturity, the interest rate will be subject to a reset rate.	$ 10,900,000	$ 9,400,000
Series 2012A Economic Development Revenue Bonds (TVAR), payable in monthly installments to satisfy annual debt service requirements through February 2042. Interest is payable at fixed rates currently ranging from 5.96% to 7.23%.	12,650,000	12,830,000
Series 2012B Economic Development Revenue Bonds (TVAR), payable in monthly installments to satisfy annual debt service requirements through February 2042. Interest is payable at fixed rates of 4.70% to 5.61% through January 2022. Beginning in February 2022 through maturity, the interest rate will become a variable rate.	8,695,000	8,855,000
	145,635,000	116,745,000
Less: current portion	(5,065,000)	(1,045,000)
Long-term debt, excluding deferred financing costs	140,570,000	115,700,000
Deferred financing costs, net of accumulated amortization	(6,011,995)	(5,688,028)
Long-term debt, net	$ 134,558,005	$ 110,011,972

The bonds are limited offerings and are not listed on any stock or other securities exchange. As security for the payment of the bonds, TVOR, TLNA, and TVAR each will grant a lien and security interest in their respective mortgaged premises and TVOR and TVAR will assign all their respective pledged assets, including gross receipts, inventory, accounts receivables, contracts rights, general intangibles and other as defined in the documents. Additionally, NLCS entered into a support agreement 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:

2017	$ 5,065,000
2018	1,955,000
2019	2,060,000
2020	2,200,000
2021	2,340,000
Thereafter	132,015,000
	$ 145,635,000

Interest expense totaled $5,103,681 in 2016 and $5,319,389 in 2015, net of capitalized interest of $2,789,364 in 2016 and $1,169,708 in 2015. Amortization of deferred financing costs included in interest expense totaled $130,236 in 2016 and $193,294 in 2015.

5. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets consist of the following as of December 31, 2016 and 2015:

	2016	2015
Funds held in trust by others	$ 333,072	$ 626,674
Capital project funds	808,128	663,774
Operating funds	1,445,471	1,435,025
	$ 2,586,671	$ 2,725,473

Net assets released from restriction totaled $50,122 for operations and $269,135 for capital purchases in 2016.

Permanently restricted net assets consist of the following as of December 31, 2016 and 2015:

	2016	2015
Funds held in trust by others	$ 1,606,927	$ 1,498,618
Benevolence endowment	747,337	489,449
	$ 2,354,264	$ 1,988,067

6. Classification of Expenses

Expenses by functional classifications for the years ended December 31, 2016 and 2015 are as follows:

	2016	2015
Program activities	$ 52,899,790	$ 50,441,776
General and administrative	13,483,332	14,933,302
Fundraising	454,962	358,303
	$ 66,838,084	$ 65,733,381

7. Pension Plan

The Organization has a 403(b) defined contribution plan. The Organization contributes 2% of all 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 $837,356 and $704,550 for the years ended December 31, 2016 and 2015, respectively.

8. 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 costs 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 $4,620,000 in 2016 and $4,952,000 in 2015, including approximately $4,385,000 in 2016 and $4,740,000 in 2015, related to the Medicaid program.

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

10. 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 consolidated financial statements.

11. 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 effects of these matters on the Organization, if any, are not presently determinable.

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidating Schedule - Balance Sheets Information
December 31, 2016

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Eliminations	Total
Assets									
Current Assets									
Cash and cash equivalents	$ 222,748	$ 5,240,869	$ -	$ -	$ 454,697	$ 5,863	$ 4,333	$ -	$ 5,928,510
Accounts receivable, net	2,026,400	107,952	43,392	-	154,445	55,089	4,661	-	2,391,939
Inventory	139,342	98,445	18,178	-	28,720	10,497	1,251	-	296,433
Prepaid expenses and other assets	354,298	407,179	28,445	-	352,520	1,923	-	-	1,144,365
Current portion of pledges receivable	17,852	87,460	-	-	-	-	-	-	105,312
Current portion of assets whose use is limited	889,430	4,813,733	511,509	-	-	-	-	-	6,214,672
Total current assets	3,650,070	10,755,638	601,524	-	990,382	73,372	10,245	-	16,081,231
Assets Whose Use is Limited, Net	5,304,029	13,974,276	906,189	-	-	-	-	-	20,184,494
Investments	17,678,647	5,942,320	1,434,711	59,692,105	-	-	-	-	84,747,783
Property and Equipment, Net	52,692,222	157,111,497	13,343,654	-	21,049,070	-	63,115	-	244,259,558
Funds Held in Trust by Others	1,939,999	-	-	-	-	-	-	-	1,939,999
Pledges Receivable, Net	14,410	23,663	-	-	-	-	-	-	38,073
Deferred Marketing Costs, Net	385,379	7,414,275	-	-	661,995	-	-	-	8,461,649
Due from Affiliates, Net	-	-	-	16,145,498	11,053,490	-	-	(27,198,988)	-
Total assets	$ 81,664,756	$ 195,221,669	$ 16,286,078	$ 75,837,603	$ 33,754,937	$ 73,372	$ 73,360	$ (27,198,988)	$ 375,712,787

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidating Schedule - Balance Sheets Information
December 31, 2016

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Eliminations	Total
Liabilities and Net Assets									
Current Liabilities									
Accounts payable	$ 603,637	$ 412,557	$ 68,123	$ -	$ 287,870	$ 9,793	$ 2,164	$ -	$ 1,384,144
Accounts payable, construction	-	1,499,819	-	-	-	-	-	-	1,499,819
Accrued interest	529,430	2,973,914	271,509	-	-	-	-	-	3,774,853
Accrued expenses	1,371,152	394,570	189,587	47,024	823,839	72,017	12,041	-	2,910,230
Current portion of long-term debt	360,000	4,465,000	240,000	-	-	-	-	-	5,065,000
Current portion of annuities payable	38,885	-	-	-	-	-	-	-	38,885
Total current liabilities	2,903,104	9,745,860	769,219	47,024	1,111,709	81,810	14,205	-	14,672,931
Resident Deposits	-	2,076,230	-	-	-	-	-	-	2,076,230
Deferred Revenue from Entrance Fees	10,448,277	26,317,244	-	-	-	-	-	-	36,765,521
Refundable Entrance Fees	-	33,536,332	-	-	-	-	-	-	33,536,332
Long-Term Debt, Net	20,204,186	98,290,450	16,063,369	-	-	-	-	-	134,558,005
Annuities Payable, Net	219,431	-	-	-	-	-	-	-	219,431
Due to Affiliates, Net	9,026,409	9,385,274	7,923,685	-	-	724,070	139,550	(27,198,988)	-
Total liabilities	42,801,407	179,351,390	24,756,273	47,024	1,111,709	805,880	153,755	(27,198,988)	221,828,450
Net Assets (Liabilities)	38,863,349	15,870,279	(8,470,195)	75,790,579	32,643,228	(732,508)	(80,395)	-	153,884,337
Total liabilities and net assets (liabilities)	$ 81,664,756	$ 195,221,669	$ 16,286,078	$ 75,837,603	$ 33,754,937	$ 73,372	$ 73,360	$ (27,198,988)	$ 375,712,787

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidating Schedule - Statements of Operations Information
Year Ended December 31, 2016

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Eliminations	Total
Unrestricted Revenues									
Net resident service revenues	$ 27,276,731	$ 13,968,961	$ 4,416,626	$ -	$ -	$ 525,997	$ 6,057	$ -	$ 46,194,372
Contributions	116,241	5,789	5,164	-	12,680	-	-	-	139,874
Management fee	-	-	-	-	4,026,334	-	-	(3,526,334)	500,000
Interest and dividends	432,915	76,714	33,803	1,432,621	-	258	-	-	1,976,311
Realized gains	123,914	28,602	3,531	394,753	-	-	-	-	550,800
Other income	4,399	14,221	2,648	-	441,945	-	-		463,213
Net assets released from restriction - operations	15,992	33,430	700	-	-	-	-	-	50,122
Total unrestricted revenues	27,970,192	14,127,717	4,462,472	1,827,374	4,480,959	526,255	6,057	(3,526,334)	49,874,692
Expenses									
Salaries and wages	14,483,732	4,208,577	2,000,247	-	3,941,393	836,836	64,680	-	25,535,465
Employee benefits and payroll taxes	3,499,576	1,091,714	613,098	-	710,843	212,218	7,162	-	6,134,611
Medicare services	2,943,244	382,750	-	-	-	-	-	-	3,325,994
Other resident care	650,939	156,262	25,700	-	-	-	-	-	832,901
Professional fees	310,224	215,438	89,155	-	655,099	107,579	40	-	1,377,535
Supplies	591,680	286,085	114,724	-	81,863	10,995	15	-	1,085,362
Food services	989,385	655,101	283,415	-	59,694	916	113	-	1,988,624
Utilities and other occupancy	1,314,010	1,608,653	301,363	-	75,021	48,440	584	-	3,348,071
Depreciation and amortization	4,177,901	5,401,253	689,335	-	95,848	-	3,322	-	10,367,659
Interest	1,288,886	2,945,934	868,861	-	-	-	-	-	5,103,681
Insurance and licenses	167,597	110,035	32,747	-	280,046	4,674	-	-	595,099
Minor equipment	93,102	88,674	24,692	-	27,233	50,026	373	-	284,100
Repairs and maintenance	646,654	437,308	106,898	-	21,675	1,935	-	-	1,214,470
Advertising and recruitment	215,718	38,608	62,973	-	304,912	107,172	6,180	-	735,563
Information technology	414,624	-	1,599	-	824,844	249	-	-	1,241,316
Legal and accounting	53,431	15,090	1,729	-	165,488	194	-	-	235,932
Dues and subscriptions	406,707	407,802	185,910	-	303,145	30,988	-	-	1,334,552
Miscellaneous	226,752	136,510	86,003	-	794,478	57,105	3,983	-	1,304,831
Bad debt expense	677,015	61,614	23,497	-	-	-	-	-	762,126
Management fee	2,197,157	874,682	426,293	-	-	28,202	-	(3,526,334)	-
Annuities	30,192	-	-	-	-	-	-	-	30,192
Total expenses	35,378,526	19,122,090	5,938,239	-	8,341,582	1,497,529	86,452	(3,526,334)	66,838,084
Operating (loss) income	(7,408,334)	(4,994,373)	(1,475,767)	1,827,374	(3,860,623)	(971,274)	(80,395)	-	(16,963,392)
Net Assets Released from Restriction - Capital Purchases	-	269,135	-	-	-	-	-	-	269,135
Unrealized Gains	990,526	233,954	46,287	2,979,804	-	-	-	-	4,250,571
Net Asset Transfers	-	-	-	(36,739,642)	36,500,876	238,766	-	-	-
Change in unrestricted net assets (liabilities)	$ (6,417,808)	$ (4,491,284)	$ (1,429,480)	$ (31,932,464)	$ 32,640,253	$ (732,508)	$ (80,395)	$ -	$ (12,443,686)

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services

Consolidating Schedule - Statements of Changes (Liabilities) in Net Assets Information
Year Ended December 31, 2016

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Eliminations	Total
Unrestricted Net Assets									
Operating (loss) income	$ (7,408,334)	$ (4,994,373)	$ (1,475,767)	$ 1,827,374	$ (3,860,623)	$ (971,274)	$ (80,395)	$ -	$ (16,963,392)
Net assets released from restriction - capital purchases	-	269,135	-	-	-	-	-	-	269,135
Unrealized gains	990,526	233,954	46,287	2,979,804	-	-	-	-	4,250,571
Net asset transfers	-	-	-	(36,739,642)	36,500,876	238,766	-	-	-
Change in unrestricted net assets (liabilities)	(6,417,808)	(4,491,284)	(1,429,480)	(31,932,464)	32,640,253	(732,508)	(80,395)	-	(12,443,686)
Temporarily Restricted Net Assets									
Contributions	225,362	248,670	-	-	25	-	-	-	474,057
Change in value of funds held in trust by others	(21,819)	-	-	-	-	-	-	-	(21,819)
Distributions of funds held in trust by others	(271,783)	-	-	-	-	-	-	-	(271,783)
Net assets released from restriction - operations	(15,992)	(33,430)	(700)	-	-	-	-	-	(50,122)
Net assets released from restriction - capital purchases	-	(269,135)	-	-	-	-	-	-	(269,135)
Change in temporarily restricted net assets	(84,232)	(53,895)	(700)	-	25	-	-	-	(138,802)
Permanently Restricted Net Assets									
Contributions	286,992	39,721	3,235	-	2,950	-	-	-	332,898
Contributions of funds held in trust by others	128,281	-	-	-	-	-	-	-	128,281
Change in value of funds held in trust by others	(19,972)	-	-	-	-	-	-	-	(19,972)
Uncollectible pledges receivable	-	(75,010)	-	-	-	-	-	-	(75,010)
Change in permanently restricted net assets (liabilities	395,301	(35,289)	3,235	-	2,950	-	-	-	366,197
Change in net assets (liabilities)	(6,106,739)	(4,580,468)	(1,426,945)	(31,932,464)	32,643,228	(732,508)	(80,395)	-	(12,216,291)
Net Assets (Liabilities), Beginning	44,970,088	20,450,747	(7,043,250)	107,723,043	-	-	-	-	166,100,628
Net Assets (Liabilities), Ending	$ 38,863,349	$ 15,870,279	$ (8,470,195)	$ 75,790,579	$ 32,643,228	$ (732,508)	$ (80,395)	$ -	$ 153,884,337