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

Consolidated Financial Statements
and Supplementary Information

December 31, 2018 and 2017

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Independent Auditors' Report

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

Emphasis of a Matter

As discussed in Note 1 to the consolidated financial statements, in 2018, National Lutheran, Inc. d/b/a National Lutheran Communities & Services 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.

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 24, 2019

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidated Balance Sheets
December 31, 2018 and 2017

	2018	2017 (As Adjusted)
Assets		
Current Assets		
Cash and cash equivalents	$ 2,623,293	$ 3,819,154
Accounts receivable, net	2,515,873	2,034,842
Prepaid expenses and other assets	793,892	1,111,881
Current portion of pledges receivable	42,844	75,074
Current portion of assets whose use is limited	6,158,864	5,505,713
Total current assets	12,134,766	12,546,664
Assets Whose Use is Limited, Net	20,651,404	14,597,578
Investments	71,378,462	77,326,998
Property and Equipment, Net	235,892,395	239,895,801
Funds Held in Trust by Others	1,928,796	1,984,790
Pledges Receivable, Net	25,100	63,862
Total assets	$ 342,010,923	$ 346,415,693

	2018	2017 (As Adjusted)
Liabilities and Net Assets		
Current Liabilities		
Accounts payable, trade	$ 2,050,408	$ 1,356,305
Accounts payable, construction	644,000	55,222
Accrued interest	3,659,874	3,745,713
Accrued expenses	3,721,491	2,904,905
Line of credit	7,907,323	-
Current portion of long-term debt	1,855,000	1,760,000
Current portion of annuities payable	32,540	35,350
Total current liabilities	19,870,636	9,857,495
Resident Deposits	6,001,758	224,643
Deferred Revenue from Entrance Fees	40,973,591	47,981,761
Refundable Entrance Fees	48,134,616	43,683,455
Long-Term Debt, Net	126,697,597	116,603,722
Annuities Payable, Net	96,623	187,563
Total liabilities	241,774,821	218,538,639
Net Assets		
Without donor restrictions	96,154,712	122,232,740
With donor restrictions	4,081,390	5,644,314
Total net assets	100,236,102	127,877,054
Total liabilities and net assets	$ 342,010,923	$ 346,415,693

See notes to consolidated financial statements

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidated Statements of Operations
Years Ended December 31, 2018 and 2017

	2018	2017 (As Adjusted)
Revenues Without Donor Restrictions		
Net resident service revenues	$ 56,494,922	$ 50,526,259
Contributions	310,932	122,586
Management fee	-	612,809
Interest and dividends	2,147,342	2,149,209
Realized gains	716,036	2,944,657
Other income	119,183	84,554
Net assets released from restriction, operations	1,380,222	203,734
Total revenues without donor restrictions	61,168,637	56,643,808
Expenses		
Salaries and wages	29,952,527	27,459,039
Employee benefits and payroll taxes	6,903,973	6,494,245
Professional fees	4,279,300	4,069,141
Ancillary and medical	4,651,828	3,958,676
Supplies	1,607,428	1,346,535
Food services	2,488,773	2,231,152
Utilities	2,427,917	2,325,727
Depreciation	11,765,170	11,835,317
Loss on sale or disposal of property and equipment	810,542	83,142
Interest	7,907,242	8,462,868
Insurance	526,019	549,590
Real estate taxes	865,549	871,363
Repairs and maintenance	1,192,205	1,150,159
Advertising and marketing	1,261,538	2,594,586
Licenses, dues and subscriptions	1,608,530	1,276,416
Other operating expenses	1,345,557	1,237,892
Bad debt expense	624,168	1,292,364
Grants awarded to others	519,592	-
Annuities	(56,073)	7,592
Total expenses	80,681,785	77,245,804
Operating loss	(19,513,148)	(20,601,996)
Net Assets Released from Restriction, Capital Purchases	566,456	-
Unrealized (Losses) Gains	(7,131,336)	3,572,262
Change in net assets without donor restrictions	$ (26,078,028)	$ (17,029,734)

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, 2018 and 2017

	2018	2017 (As Adjusted)
Net Assets without Donor Restrictions		
Operating loss	$ (19,513,148)	$ (20,601,996)
Net assets released from restriction, capital purchases	566,456	-
Unrealized (losses) gains	(7,131,336)	3,572,262
Change in net assets with donor restrictions	(26,078,028)	(17,029,734)
Net Assets with Donor Restrictions		
Contributions	439,748	862,322
Change in value of funds held in trust by others	(55,994)	44,791
Net assets released from restriction, operations	(1,380,222)	(203,734)
Net assets released from restriction, capital purchases	(566,456)	-
Change in net assets with donor restrictions	(1,562,924)	703,379
Change in net assets	(27,640,952)	(16,326,355)
Net Assets, Beginning as Previously Reported	-	153,884,337
Cumulative Effect of Change in Accounting Principle	-	(9,680,928)
Net Assets, Beginning as Adjusted	127,877,054	144,203,409
Net Assets, Ending	$ 100,236,102	$ 127,877,054

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, 2018 and 2017

	2018	2017 (As Adjusted)
Cash Flows from Operating Activities		
Change in net assets	$ (27,640,952)	$ (16,326,355)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	11,765,170	11,835,317
Amortization of deferred financing costs	205,675	200,717
Amortization of entrance fees	(6,753,968)	(5,351,793)
Proceeds from non-refundable entrance fees, turnover units	3,759,807	1,522,415
Realized gains	(716,036)	(2,944,657)
Unrealized losses (gains)	7,131,336	(3,572,262)
Donor restricted contributions	(439,748)	(862,322)
Change in allowance for uncollectible accounts receivable	(581,329)	317,440
Change in value of funds held in trusts by others	55,994	(44,791)
Change in annuities payable, net	(93,750)	(35,403)
Loss on sale or disposal of property and equipment	810,542	83,293
Changes in assets and liabilities:		
Accounts receivable	100,298	39,657
Prepaid expenses and other assets	317,989	328,917
Accounts payable and accrued expenses	1,424,850	(7,082)
Net cash used in operating activities	(10,654,122)	(14,816,909)
Cash Flows from Investing Activities		
Net proceeds from sales of investments and assets whose use is limited	(7,173,741)	20,233,579
Purchases of property and equipment	(7,983,528)	(10,273,951)
Net cash (used in) provided by investing activities	(15,157,269)	9,959,628

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, 2018 and 2017

	2018	2017 (As Adjusted)
Cash Flows from Financing Activities		
Proceeds from issuance of long-term debt	$ 13,500,000	$ -
Proceeds from borrowing on line of credit	7,907,323	-
Principal payments on long-term debt	(1,760,000)	(21,460,000)
Payments for financing costs	(1,756,800)	-
Net change in resident deposits	5,777,115	279,996
Proceeds from entrance fees, new units	-	24,007,203
Proceeds from refundable entrance fees, turnover units	5,116,658	3,216,995
Refunds of entrance fees	(4,679,506)	(4,163,040)
Donor restricted contributions	439,748	862,322
Change in pledges receivable, net	70,992	4,449
Net cash provided by financing activities	24,615,530	2,747,925
Net change in cash and cash equivalents	(1,195,861)	(2,109,356)
Cash and Cash Equivalents, Beginning	3,819,154	5,928,510
Cash and Cash Equivalents, Ending	$ 2,623,293	$ 3,819,154
Supplementary Cash Flows Information		
Interest paid, net of interest capitalized	$ 7,787,406	$ 8,291,291
Supplementary Disclosure of Noncash Investing and Financing Activities		
Accounts payable, construction	$ 644,000	$ 55,222

1. Organization and Summary of Significant Accounting Policies

Organization

National Lutheran, Inc. ("NLI"), a Maryland not-for-profit corporation, is the parent corporation of a system doing business as National Lutheran Communities and Services ("NLCS"). NLI is 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. 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:

National Lutheran Home for the Aged, Inc. ("NLHA") is a Maryland not-for-profit corporation that is a supporting organization to NLCS.

The Village at Rockville, Inc. ("TVAR"), a not-for-profit corporation originally incorporated in the District of Columbia, operates a retirement community in Rockville, Maryland which includes 144 independent living units, 50 assisted living units, and 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 now consists of 324 independent living units, 20 skilled nursing units and 18 assisted living 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 Providence Point ("TVPP"), a Maryland not-for-profit corporation, was formed to acquire and develop property located in Annapolis, Maryland as a continuing care retirement community. TVPP has entered into land purchase option and developer agreements related to the project. The development is in its planning and development stages and TVPP had no operations during 2018 or 2017 as all initial costs are being paid by NLI. TVPP is awaiting various approvals to begin marketing and construction. During February 2019, TVPP received approvals from the Maryland Department of Aging and has begun marketing the project.

Impact 1890, LLC was incorporated as a Maryland limited liability corporation to make grants exclusively for non-profit organizations that promote the health and welfare of senior citizens.

NLI is a 90 percent owner of Primrose Intel, LLC. (Primrose). Primrose was established as a for-profit entity for the purposes of developing and marketing software and other technology solutions for providers of care to senior citizens.

Community Services, LLC was incorporated as a Maryland limited liability corporation to own and manage community clinics and home health organizations for the benefit of seniors. Community Services, LLC is the sole member of the following corporations:

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 ("Rockville Clinic") is a Maryland limited liability corporation began operations in 2017 and operates 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, TVPP, Primrose, Impact 1890, LLC and Community Services, LLC and its subsidiaries, myPotential MD, myPotential VA, and Rockville Clinic, 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 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 $432,289 and $1,013,618 at December 31, 2018 and 2017, respectively.

Assets Whose Use is Limited, Investment Risk and Investments

Assets held as operating reserves and assets held under indenture agreements are classified as assets whose use is limited and are reported separately in the accompanying consolidated balance sheets. Assets whose use is limited that are required for obligations classified as current liabilities are reported as current assets. Investments and assets whose use is limited are reported in the accompanying consolidated 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 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 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 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 $16,986 and $15,438 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 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 percent to 7.50 percent to determine the present value of the actuarially determined liability.

Entrance Fees

TVAR'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.

TVAR also has a rental agreement requiring no entrance fee.

TVOR'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 a 100 percent guaranteed refund entrance fee option. The refundable portion of the traditional entrance fee is calculated based on a 18 month amortization period after applying a 10 percent administrative fee. After 18 months of occupancy, no refund is payable to the resident. The refundable portion of the 50 percent entrance fee is calculated based on an 8 month amortization period after applying a 10 percent administrative fee. After 8 months of occupancy, the refund payable to the resident is limited to 50 percent of the entrance fee. The 100 percent entrance fee guarantees a 100 percent refund of the entrance fee paid. 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 $46,450,000 and $52,900,000 at December 31, 2018 and 2017, respectively.

TVAR also has a rental agreement requiring no entrance fee on select independent living units, but a one-time community fee of $3,000 applies.

At TLNA, each resident executes a Resident’s Admission and Service 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.

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 $205,675 in 2018 and $200,717 in 2017.

Accumulated amortization was $1,047,972 and $842,297 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 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

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 consolidated balance sheets.

Home Care/Home Health: Revenues consist of home care services and home health services. Home care revenues include services provided by caregivers to assist with activities of daily living and other services. Home health revenues include medical care provided by skilled medical professionals and is often prescribed as part of a care plan. The Organization has determined that home care agency revenues are considered one performance obligation which is satisfied over time as services are provided. Therefore, home care agency revenues are recognized on a daily basis as services are rendered.

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 independent living revenues was $6,753,968 in 2018 and $5,351,793 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:

	Skilled Nursing	Assisted Living	Independent Living	Home Care/ Home Health	Other Resident Services	Total
			2018			
Self-pay	$ 6,353,429	$ 10,442,260	$ 13,622,153	$ 1,187,385	$ 784,967	$ 32,390,194
Medicare	10,688,935	-	-	519,736	-	11,208,671
Medical Assistance	5,104,256	-	-	-	-	5,104,256
Commercial insurance	1,037,833	-	-	-	-	1,037,833
Amortization of nonrefundable entrance fees	-	-	6,753,968	-	-	6,753,968
Total	$ 23,184,453	$ 10,442,260	$ 20,376,121	$ 1,707,121	$ 784,967	$ 56,494,922
			2017			
Self-pay	$ 5,107,766	$ 9,754,842	$ 12,782,386	$ 708,917	$ 734,275	$ 29,088,186
Medicare	9,584,467	-	-	214,831	-	9,799,298
Medical Assistance	5,322,592	-	-	-	-	5,322,592
Commercial insurance	964,390	-	-	-	-	964,390
Amortization of nonrefundable entrance fees	-	-	5,351,793	-	-	5,351,793
Total	$ 20,979,215	$ 9,754,842	$ 18,134,179	$ 923,748	$ 734,275	$ 50,526,259

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 ("ADL"s), 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.

Advertising

The Organization expenses advertising costs as incurred. Advertising expense totaled approximately $1,262,000 and $2,595,000 for the years ended December 31, 2018 and 2017, respectively.

Operating Loss

The consolidated 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

NLI, NLHA, TVAR, TVOR, TLNA, and TVPP 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. Primrose, Impact 1890, LLC and 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.

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 and amortization expense was decreased for the amount recorded for amortization of deferred marketing costs in 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	$ 9,471,876	$ (9,471,876)	$ -
Property and equipment, net	241,115,080	(1,219,279)	239,895,801
Total assets	357,106,848	(10,691,155)	346,415,693
Net assets,			
Net assets without donor restriction	132,923,895	(10,691,155)	122,232,740
Total net assets	138,568,209	(10,691,155)	127,877,054
Total liabilities and net assets	357,106,848	(10,691,155)	346,415,693
Statement of Operations:			
Expenses:			
Depreciation	12,726,199	(890,882)	11,835,317
Advertising and marketing	693,477	1,901,109	2,594,586
Total expenses	76,235,577	1,010,227	77,245,804
Operating loss	(19,591,769)	(1,010,227)	(20,601,996)
Change in net assets without donor restrictions	(16,019,507)	(1,010,227)	(17,029,734)
Statement of Changes in Net Assets:			
Change in net assets without donor restriction	(16,019,507)	(1,010,227)	(17,029,734)
Change in net assets	(15,316,128)	(1,010,227)	(16,326,355)
Net assets, beginning	153,884,337	(9,680,928)	144,203,409
Net assets, ending	138,568,209	(10,691,155)	127,877,054
Statement of Cash Flows:			
Change in net assets	(15,316,128)	(1,010,227)	(16,326,355)
Depreciation	12,726,199	(890,882)	11,835,317
Donor restricted contributions re-class	(127,476)	(734,846)	(862,322)
Net cash used in operating activities	(12,180,954)	(2,635,955)	(14,816,909)
Payment of deferred marketing costs	(1,901,109)	1,901,109	-
Net cash provided by investing activities	8,058,519	1,901,109	9,959,628
Donor restricted contributions re-class	127,476	734,846	862,322
Net cash provided by financing activities	2,013,079	734,846	2,747,925

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 consolidated 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 7).

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 consolidated 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 consolidated financial statements.

Reclassifications

Certain items in the 2017 consolidated financial statements have been reclassified to conform to the 2018 consolidated 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 consolidated financial statements were issued.

During March 2019, the Economic Development Authority of the City of Staunton, Virginia issued, on behalf of TLNA, $9,890,000 Residential Care Facility Revenue Bonds, Series 2019 (the "Series 2019 Bonds") to finance the expansion/repositioning project as described in Note 4. The Series 2019 Bonds are payable initially with interest only at 5.25% with principal payments beginning July 2021 to July 2024.

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 consolidated 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	$ 26,977,766	$ 26,977,766	$ 26,977,766	$ -	$ -
Equity securities:					
Consumer discretionary	9,818,721	9,818,721	9,818,721	-	-
Consumer staples	2,113,430	2,113,430	2,113,430	-	-
Energy	3,287,314	3,287,314	3,287,314	-	-
Financial	3,378,585	3,378,585	3,378,585	-	-
Health care	4,552,958	4,552,958	4,552,958	-	-
Industrials	2,529,053	2,529,053	2,529,053	-	-
Information technology	3,751,897	3,751,897	3,751,897	-	-
Materials	767,115	767,115	767,115	-	-
Real estate	1,572,852	1,572,852	1,572,852	-	-
Utilities	1,177,591	1,177,591	1,177,591	-	-
Other	1,357,604	1,357,604	1,357,604	-	-
Mutual funds:					
Equity	10,966,547	10,966,547	10,966,547	-	-
Fixed income	6,326,906	6,326,906	6,326,906	-	-
Exchange-traded and closed-end funds	84,593	84,593	84,593	-	-
Other	81,313	81,313	-	81,313	-
Fixed income securities:					
Corporate bonds	8,916,188	8,916,188	-	8,916,188	-
U.S. government and agency bonds	7,238,280	7,238,280	-	7,238,280	-
Subtotal	94,898,713	94,898,713	78,662,932	16,235,781	-
Alternative investment measured at NAV	3,290,017				
Total	98,188,730				
Funds held in trust by others	1,928,796	1,928,796	-	-	1,928,796
Total assets	$ 100,117,526	$ 96,827,509	$ 78,662,932	$ 16,235,781	$ 1,928,796
Disclosed at Fair Value					
Cash and cash equivalents	$ 2,623,293	$ 2,623,293	$ 2,623,293	$ -	$ -
Pledges receivable, net	$ 67,944	$ 67,944	$ -	$ 67,944	$ -
Long-term debt	$ 135,915,000	$ 134,810,092	$ -	$ 134,810,092	$ -

	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	$ 18,477,905	$ 18,477,905	$ 18,477,905	$ -	$ -
Equity securities:					
Consumer discretionary	5,364,053	5,364,053	5,364,053	-	-
Consumer staples	1,216,587	1,216,587	1,216,587	-	-
Energy	2,415,296	2,415,296	2,415,296	-	-
Financial	3,485,408	3,485,408	3,485,408	-	-
Health care	3,846,721	3,846,721	3,846,721	-	-
Industrials	3,019,104	3,019,104	3,019,104	-	-
Information technology	6,072,068	6,072,068	6,072,068	-	-
Materials	1,265,811	1,265,811	1,265,811	-	-
Real estate	3,262,983	3,262,983	3,262,983	-	-
Utilities	2,804,327	2,804,327	2,804,327	-	-
Other	3,572,981	3,572,981	3,572,981	-	-
Mutual funds:					-
Equity	12,014,105	12,014,105	12,014,105	-	-
Fixed income	8,436,963	8,436,963	8,436,963	-	-
Exchange-traded and closed-end funds	70,730	70,730	70,730	-	-
Other	81,463	81,463	-	81,463	-
Fixed income securities:					
Corporate bonds	10,450,527	10,450,527	-	10,450,527	-
U.S. government and agency bonds	8,363,071	8,363,071	-	8,363,071	-
Subtotal	94,220,103	94,220,103	75,325,042	18,895,061	-
Alternative investment measured at NAV	3,210,186				
Total	97,430,289				
Funds held in trust by others	1,984,790	1,984,790	-	-	1,984,790
Total assets	$ 99,415,079	$ 96,204,893	$ 75,325,042	$ 18,895,061	$ 1,984,790
Disclosed at Fair Value					
Cash and cash equivalents	$ 3,819,154	$ 3,819,154	$ 3,819,154	$ -	$ -
Pledges receivable, net	$ 138,936	$ 138,936	$ -	$ 138,936	$ -
Long-term debt	$ 124,175,000	$ 126,727,426	$ -	$ 126,727,426	$ -

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 consolidated balance sheets.

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

	2018	2017
Investments	$ 71,378,462	$ 77,326,998
Assets whose use is limited:		
Refundable deposits	$ 5,676,330	$ 2,759,798
Operating reserves	4,714,016	4,438,360
Assets held under trust indentures:		
Debt service reserves	6,453,551	5,056,689
Principal and interest	5,977,573	7,605,812
Construction	3,746,260	-
Other	242,538	242,632
Total assets whose use is limited	26,810,268	20,103,291
Less current portion of assets whose use is limited	(6,158,864)	(5,505,713)
Assets whose use is limited, net	$ 20,651,404	$ 14,597,578

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 percent of the facility's net operating expenses (as defined) for the most recent fiscal year. The reserve required is calculated as $4,714,016 and $4,438,360 at December 31, 2018 and 2017, respectively. Beginning January 1, 2023, the reserve requirement will be equal to 25 percent of TVAR's net operating expenses.

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 consolidated statements of operations and changes in net assets as an increase or decrease in net assets with donor restrictions.

Valuation Methodologies

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

Equity securities, exchange traded funds 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.

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 alternative investment as of December 31, 2018 and 2017 was $3,290,217 and $3,210,086, 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.

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.

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.

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 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, 2018 and 2017. 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.

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

	2018					
	Less than Twelve Months		More than Twelve Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Equity securities	$ 12,194,486	$ (1,147,907)	$ 536,762	$ (341,612)	$ 12,731,248	$ (1,486,519)
Mutual funds	-	-	6,528,061	(1,275,949)	6,528,061	(1,275,949)
Fixed income securities	6,961,966	(214,093)	6,065,428	(187,140)	13,027,394	(401,233)
	$ 19,156,452	$ (1,362,000)	$ 13,130,251	$ (1,804,701)	$ 32,286,703	$ (3,163,701)
	2018					
Equity securities	$ 3,786,333	$ (111,722)	$ 2,651,737	$ (410,021)	$ 6,438,070	$ (521,743)
Mutual funds	257,456	(31,783)	7,482,551	(631,924)	7,740,007	(663,708)
Fixed income securities	4,453,185	(34,765)	3,646,812	(53,912)	8,099,997	(88,677)
	$ 8,496,974	$ (178,270)	$ 13,781,100	$ (1,095,857)	$ 22,278,074	$ (1,274,128)

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, resident deposits, and donor restricted funds.

Financial assets:	
Cash and cash equivalents	$ 2,623,293
Investments	71,378,462
Accounts receivable, net	2,515,873
Total	$ 76,517,628

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.

To assist management satisfy any unanticipated liquidity needs, the Organization has a $10,000,000 line of credit with a bank that can be drawn upon (Note 5).

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	$ 19,050,712	$ 19,050,712
Land improvements	12,052,638	12,052,638
Buildings and building improvements	239,191,113	233,269,886
Furniture and equipment	23,654,443	23,245,086
Construction in progress	21,916,972	20,499,079
	315,865,878	308,117,401
Less accumulated depreciation	(79,973,483)	(68,221,600)
	$ 235,892,395	$ 239,895,801

During 2018, the Organization determined that several projects were not deemed reasonable to complete and therefore were terminated. The total write off of these costs was approximately $801,000 and is included in loss on disposal of property and equipment on the accompanying consolidated statement of operations.

Construction in progress consists primarily of the following:

Initial project development costs for a planned expansion and repositioning project at TVAR expecting to consist of an addition of 132 independent living units in place of 33 of its existing independent living units. In addition, the expansion phase will add additional common space, dining rooms and underground parking. A construction contract exists in the amount of approximately $54,800,000 of which $612,000 was completed as of December 31, 2018.

Initial planning costs for future expansion/renovation projects at TLNA. There are no material commitments on these projects at December 31, 2018.

Planning and pre-development costs for TVPP of approximately $15,000,000. TVPP has various development and purchase agreements in place subject to various approvals and timetables. During February 2019, TVPP received approvals from the Maryland Department of Aging and has begun marketing the project.

5. Long-Term Debt and Line-of-Credit

During March 2018, the Organization entered into a variable rate line of credit (4.70 percent at December 31, 2018) for $10,000,000 with Morgan Stanley Bank, N.A. collateralized by a portion of its investments. The balance outstanding on this line of credit at December 31, 2018 was $7,907,323.

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

	2018	2017
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 percent through December 31, 2019, and then 6.625 percent through June 2021. Beginning in July 2021, the interest rate will become a variable rate through maturity.	$ 16,275,000	$ 16,535,000
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 percent to 7.80 percent. Beginning July 2018 through maturity, interest is payable at a fixed rate of 6.5 percent.	38,955,000	39,340,000
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 percent to 6.83 percent.	36,415,000	36,935,000
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 percent to 5.04 percent. Beginning in July 2024 through maturity, the interest rate will be subject to a reset rate.	10,160,000	10,380,000
Series 2018A Fixed Rate Economic Development Revenue Bonds (TVAR), 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 (TVAR), 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	-

	2018	2017
Series 2018D Adjustable Rate Economic Development Revenue Bonds (TVAR), 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 (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 percent.	12,250,000	12,455,000
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 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
	135,915,000	124,175,000
Less: current portion	(1,855,000)	(1,760,000)
Long-term debt, excluding deferred financing costs	134,060,000	122,415,000
Deferred financing costs, net of accumulated amortization	(7,362,403)	(5,811,278)
Long-term debt, net	$ 126,697,597	$ 116,603,722

The TVAR Series 2018 Bonds are draw down bonds to fund the TVAR 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, TVOR, TLNA, and TVAR each has granted 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, 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	$ 1,855,000
2020	1,985,000
2021	2,120,000
2022	2,355,000
2023	3,060,000
Thereafter	124,540,000
	$ 135,915,000

Interest expense totaled $7,907,242 in 2018 and $8,462,868 in 2017, net of capitalized interest of $88,238 in 2018.

6. Net Assets

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

	2018	2017
Net assets:		
Without donor restrictions:		
Undesignated	$ 91,440,696	$ 117,794,380
Maryland Department of Aging reserve requirements	4,714,016	4,438,360
	96,154,712	122,232,740
With donor restrictions:		
Purpose restricted for:		
Operations	328,783	1,775,903
Capital projects	689,631	1,008,808
Charitable remainder trusts	394,268	421,038
Perpetual trusts	1,534,528	1,606,377
Restricted in perpetuity	1,134,180	832,188
	4,081,390	5,644,314
Total net assets	$ 100,236,102	$ 127,877,054

During 2018 and 2017, net assets of $1,380,222 and $203,734, 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. Expenses by Nature and Function

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

	Resident Services	General and Administrative	Fundraising	Total
Salaries and wages	$ 23,722,140	$ 5,551,504	$ 678,883	$ 29,952,527
Employee benefits and payroll taxes	5,793,483	942,029	168,461	6,903,973
Professional fees	2,527,585	1,734,894	16,821	4,279,300
Ancillary and medical	4,651,828	-	-	4,651,828
Supplies	909,844	681,786	15,798	1,607,428
Food services	2,418,800	69,973	-	2,488,773
Utilities	2,350,007	77,910	-	2,427,917
Depreciation	11,725,219	39,951	-	11,765,170
Loss on sale or disposal of property and equipment	810,542	-	-	810,542
Interest	7,749,919	157,323	-	7,907,242
Insurance	230,505	295,514	-	526,019
Real estate taxes	865,549	-	-	865,549
Repairs and maintenance	891,172	301,033	-	1,192,205
Advertising and marketing	547,655	658,480	55,403	1,261,538
Licenses, dues and subscriptions	1,059,406	516,313	32,811	1,608,530
Other operating expenses	136,224	1,209,333	-	1,345,557
Bad debt expense	624,168	-	-	624,168
Impact community expense	519,592	-	-	519,592
Annuities	(56,073)	-	-	(56,073)
Total	$ 67,477,565	$ 12,236,043	$ 968,177	$ 80,681,785

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, including depreciation and interest, are allocated to a function on a square footage basis.

In 2017, $62,731,640 of expenses related to resident services, $14,076,101 related to general and administrative, and $438,063 related to fundraising.

8. Pension Plan

The Organization has a 403(b) defined contribution plan. The Organization contributes 2 percent of all 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 $876,515 and $879,042 for the years ended December 31, 2018 and 2017, respectively.

9. Benevolent Care

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

The Organization maintains records to identify and monitor the level of benevolent care it provides. The estimated cost of providing benevolent care is based upon the direct and indirect costs identified with the specific benevolent care provided. The cost of benevolent care provided amounted to approximately $3,682,100 in 2018 and $5,360,000 in 2017, including approximately $3,430,100 in 2018 and $4,839,000 in 2017, related to the Medicaid program.

10. Risk

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

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

The Organization 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.

11. Medical Malpractice Claims Coverage

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

12. Contingencies

The senior living services industry is subject to numerous laws, regulations, and administrative directives of federal, state, and local governments and agencies. Compliance with these laws, regulations, and administrative directives is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for resident services previously billed. Management is not aware of any material incidents of noncompliance; however, the possible future 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 Sheet Information
December 31, 2018

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Rockville Clinic	Primrose	Impact 1890	Eliminations	Total
Assets												
Current Assets												
Cash and cash equivalents	$ 210,152	$ 172,212	$ -	$ -	$ 1,885,642	$ -	$ -	$ 10,273	$ 345,014	$ -	$ -	$ 2,623,293
Accounts receivable, net	1,935,675	275,753	24,906	-	5,461	213,676	29,617	30,785	-	-	-	2,515,873
Prepaid expenses and other assets	244,322	72,210	26,779	-	423,889	16,096	10,596	-	-	-	-	793,892
Current portion of pledges receivable	8,344	34,500	-	-	-	-	-	-	-	-	-	42,844
Current portion of assets whose use is limited	1,636,384	3,820,271	702,209	-	-	-	-	-	-	-	-	6,158,864
Total current assets	4,034,877	4,374,946	753,894	-	2,314,992	229,772	40,213	41,058	345,014	-	-	12,134,766
Assets Whose Use is Limited, Net	16,695,043	3,237,554	718,807	-	-	-	-	-	-	-	-	20,651,404
Investments	17,798,942	19,327,863	2,036,379	32,215,278	750,000	-	-	-	-	-	(750,000)	71,378,462
Property and Equipment, Net	53,707,399	153,744,476	12,943,974	-	15,442,441	8,104	36,540	4,854	4,607	-	-	235,892,395
Funds Held in Trust by Others	1,928,796	-	-	-	-	-	-	-	-	-	-	1,928,796
Pledges Receivable, Net	-	25,100	-	-	-	-	-	-	-	-	-	25,100
Total assets	$ 94,165,057	$ 180,709,939	$ 16,453,054	$ 32,215,278	$ 18,507,433	$ 237,876	$ 76,753	$ 45,912	$ 349,621	$ -	$ (750,000)	$ 342,010,923

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidating Schedule, Balance Sheet Information
December 31, 2018

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Rockville Clinic	Primrose	Impact 1890	Eliminations	Total
Liabilities and Net Assets												
Current Liabilities												
Accounts payable, trade	$ 975,093	$ 343,279	$ 168,615	$ -	$ 398,936	$ 14,117	$ 5,169	$ 1,185	$ 4,014	$ 140,000	$ -	$ 2,050,408
Accounts payable, construction	644,000	-	-	-	-	-	-	-	-	-		644,000
Accrued interest	592,384	2,640,271	427,219	-	-	-	-	-	-	-	-	3,659,874
Accrued expenses	1,711,597	698,112	249,238	42,740	827,923	103,117	62,574	21,058	5,132	-	-	3,721,491
Line of credit	-	-	-	7,907,323	-	-	-	-	-	-	-	7,907,323
Current portion of long-term debt	400,000	1,180,000	275,000	-	-	-	-	-	-	-	-	1,855,000
Current portion of annuities payable	32,540	-	-	-	-	-	-	-	-	-	-	32,540
Total current liabilities	4,355,614	4,861,662	1,120,072	7,950,063	1,226,859	117,234	67,743	22,243	9,146	140,000	-	19,870,636
Resident Deposits	5,703,688	298,070	-	-	-	-	-	-	-	-	-	6,001,758
Deferred Revenue from Entrance Fees	8,286,257	32,687,334	-	-	-	-	-	-	-	-	-	40,973,591
Refundable Entrance Fees	1,929,313	46,205,303	-	-	-	-	-	-	-	-	-	48,134,616
Long-Term Debt, Net	31,234,852	79,901,312	15,561,433		-	-	-	-	-	-	-	126,697,597
Annuities Payable, Net	96,623	-	-	-	-	-	-	-	-	-	-	96,623
Due to (From) Affiliates, Net	20,605,254	20,963,292	10,470,342	(53,520,242)	(2,852,768)	2,556,439	817,749	378,545	-	581,389	-	-
Total liabilities	72,211,601	184,916,973	27,151,847	(45,570,179)	(1,625,909)	2,673,673	885,492	400,788	9,146	721,389	-	241,774,821
Net Assets (Deficit)	21,953,456	(4,207,034)	(10,698,793)	77,785,457	20,133,342	(2,435,797)	(808,739)	(354,876)	340,475	(721,389)	(750,000)	100,236,102
Total liabilities and net assets (deficit)	$ 94,165,057	$ 180,709,939	$ 16,453,054	$ 32,215,278	$ 18,507,433	$ 237,876	$ 76,753	$ 45,912	$ 349,621	$ -	$ (750,000)	$ 342,010,923

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidating Schedule, Statement of Operations Information
Year Ended December 31, 2018

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Rockville Clinic	Primrose	Impact 1890	Eliminations	Total
Revenues Without Donor Restrictions												
Net resident service revenues	$ 27,665,676	$ 21,664,128	$ 5,438,288	$ -	$ 2,438	$ 1,298,451	$ 362,083	$ 109,418	$ -	$ -	$ (45,560)	$ 56,494,922
Contributions	223,938	76,065	2,973	-	7,956	-	-	-	-	-	-	310,932
Management fee	-	-	-	-	4,500,452	-	-	-	-	-	(4,500,452)	-
Interest and dividends	549,059	511,520	69,433	993,109	25,365	(349)	(135)	(660)	-	-	-	2,147,342
Realized gains	200,216	70,302	10,221	435,297	-	-	-	-	-	-	-	716,036
Other income	154,086	51,370	5,298	-	74,288	-	-	-	-	-	(165,859)	119,183
Net assets released from restriction, operations	441,972	923,064	12,776	-	2,410	-	-	-	-	-	-	1,380,222
Total revenues without donor restrictions	29,234,947	23,296,449	5,538,989	1,428,406	4,612,909	1,298,102	361,948	108,758	-	-	(4,711,871)	61,168,637
Expenses												
Salaries and wages	14,633,483	5,396,053	2,446,110	-	5,110,838	1,373,232	550,023	183,762	259,026	-	-	29,952,527
Employee benefits and payroll taxes	3,567,943	1,311,137	711,344	-	913,985	283,096	91,907	14,081	10,480	-	-	6,903,973
Professional fees	1,291,037	665,931	225,700	-	1,887,800	47,853	18,841	9,000	9,654	134,104	(10,620)	4,279,300
Ancillary and medical	3,602,751	1,003,060	4,674	-	-	-	-	41,343	-	-	-	4,651,828
Supplies	652,930	514,318	149,943	-	226,714	39,901	2,847	-	9,795	10,980	-	1,607,428
Food services	1,071,859	1,043,609	319,250	-	52,534	1,173	182	-	166	-	-	2,488,773
Utilities	1,141,400	958,500	185,780	-	59,340	78,716	2,581	1,600	-	-	-	2,427,917
Depreciation	4,162,713	7,004,487	540,449	-	39,951	2,508	13,287	1,533	242	-	-	11,765,170
Loss on sale or disposal of property and equipment	-	-	-	-	810,542	-	-	-	-	-	-	810,542
Interest	1,235,470	5,683,128	831,322	157,322	-	-	-	-	-	-	-	7,907,242
Insurance	58,700	103,983	13,074	-	295,514	38,555	12,611	3,500	82	-	-	526,019
Real estate taxes	273,714	514,805	76,255	-	-	-	300	475	-	-	-	865,549
Repairs and maintenance	536,924	530,636	83,586	-	28,514	11,024	-	1,346	175	-	-	1,192,205
Advertising and marketing	724,410	110,921	30,352	-	323,630	54,057	5,341	-	3,701	9,126	-	1,261,538
Licenses, dues and subscriptions	617,553	420,800	195,953	-	303,174	39,956	13,912	2,069	2,208	12,905	-	1,608,530
Other operating expenses	359,802	201,802	85,412	-	588,786	115,953	17,733	58,190	11,911	4,682	(98,714)	1,345,557
Bad debt expense	510,341	1,064	35,419	-	-	29,769	21,877	25,698	-	-	-	624,168
Management fee	2,440,001	1,515,000	443,000	-	-	55,549	16,902	-	-	30,000	(4,500,452)	-
Grants awarded to others	-	-	-	-	-	-	-	-	-	519,592	-	519,592
Annuities	(56,073)	-	-	-	-	-	-	-	-	-	-	(56,073)
Total expenses	36,824,958	26,979,234	6,377,623	157,322	10,641,322	2,171,342	768,344	342,597	307,440	721,389	(4,609,786)	80,681,785
Operating (loss) income	(7,590,011)	(3,682,785)	(838,634)	1,271,084	(6,028,413)	(873,240)	(406,396)	(233,839)	(307,440)	(721,389)	(102,085)	(19,513,148)
Net Assets Released from Restriction, Capital	566,456	-	-	-	-	-	-	-	-	-	-	566,456
Unrealized Losses	(1,914,745)	(1,125,176)	(150,799)	(3,940,616)	-	-	-	-	-	-	-	(7,131,336)
Capital Contribution	-	-	-	-	-	-	-	-	647,915	-	(647,915)	-
Change in net assets (deficit) without donor restrictions	$ (8,938,300)	$ (4,807,961)	$ (989,433)	$ (2,669,532)	$ (6,028,413)	$ (873,240)	$ (406,396)	$ (233,839)	$ 340,475	$ (721,389)	$ (750,000)	$ (26,078,028)

National Lutheran, Inc.
d/b/a National Lutheran Communities & Services
Consolidating Schedule, Statement of Changes in Net Assets (Deficit) Information
Year Ended December 31, 2018

	TVAR	TVOR	TLNA	NLHA	NLI	myPotential VA	myPotential MD	Rockville Clinic	Primrose	Impact 1890	Eliminations	Total
Net Assets without Donor Restrictions												
Operating (loss) income	$ (7,590,011)	$ (3,682,785)	$ (838,634)	$ 1,271,084	$ (6,028,413)	$ (873,240)	$ (406,396)	$ (233,839)	$ (307,440)	$ (721,389)	$ (102,085)	$ (19,513,148)
Net assets released from restriction, capital	566,456	-	-	-	-	-	-	-	-	-	-	566,456
Unrealized losses	(1,914,745)	(1,125,176)	(150,799)	(3,940,616)	-	-	-	-	-	-	-	(7,131,336)
Capital contribution	-	-	-	-	-	-	-	-	647,915	-	(647,915)	-
Change in net assets (deficit) without donor restrictions	(8,938,300)	(4,807,961)	(989,433)	(2,669,532)	(6,028,413)	(873,240)	(406,396)	(233,839)	340,475	(721,389)	(750,000)	(26,078,028)
Net Assets with Donor Restriction												
Contributions	173,256	218,860	30,255	-	17,377	-	-	-	-	-	-	439,748
Change in value of funds held in trust by others	(55,994)	-	-	-	-	-	-	-	-	-	-	(55,994)
Net assets released from restriction, operations	(441,972)	(923,064)	(12,776)	-	(2,410)	-	-	-	-	-	-	(1,380,222)
Net assets released from restriction - capital purchases	(566,456)	-	-	-	-	-	-	-	-	-	-	(566,456)
Change in net assets with donor restrictions	(891,166)	(704,204)	17,479	-	14,967	-	-	-			-	(1,562,924)
Change in net assets (deficit)	(9,829,466)	(5,512,165)	(971,954)	(2,669,532)	(6,013,446)	(873,240)	(406,396)	(233,839)	340,475	(721,389)	(750,000)	(27,640,952)
Net Assets (Deficit), Beginning	31,782,922	1,305,131	(9,726,839)	80,454,989	26,146,788	(1,562,557)	(402,343)	(121,037)	-	-	-	127,877,054
Net Assets (Deficit), Ending	$ 21,953,456	$ (4,207,034)	$ (10,698,793)	$ 77,785,457	$ 20,133,342	$ (2,435,797)	$ (808,739)	$ (354,876)	$ 340,475	$ (721,389)	$ (750,000)	$ 100,236,102