

**Tallahassee Memorial HealthCare, Inc. and
Subsidiaries**
Annual Report
For the Fiscal Year Ended
September 30, 2016, 2015 and 2014

Tallahassee Memorial HealthCare, Inc. and Subsidiaries

Index

September 30, 2016, 2015 and 2014

	Page(s)
Management's Discussion and Analysis of Recent Financial Performance	3
Historical Utilization	5
Sources of Patient Service Revenue	6
Historical Maximum Annual Debt Service Coverage Ratio	7
Capitalization	8
Liquidity	9

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF RECENT FINANCIAL
PERFORMANCE**

The operating performance of TMH has remained stable over the three most recently completed fiscal years. Growth in Total Revenues, Gains and Other Support is the result of higher medical/surgical admissions, an increase in the complexity of operating and other procedures, growth in the number of emergency room visits, an increase in the number of physician office visits and successful contract negotiations with third-party payers. The TMH strategic plan includes a number of strategies and tactics which have focused colleagues on improving quality performance while serving the less advantaged populations in the service area. Creative initiatives such as the opening of the Transition Center which has reduced the number of readmissions of chronic disease patients and reduced unnecessary emergency room visits have contributed to the stable performance. Certain eligible patient populations are screened for the opportunity for referral to the Transition Center, which is a multi-disciplinary clinic that provides physician, nursing, and social work services on an outpatient basis with the goal of reducing hospital utilization. The typical patient of the Transition Center has limited economic means.

The operating margin for the fiscal years ending September 30, 2016, 2015 and 2014 were 6.8%, 6.9%, and 6.5%, respectively. Total acute care admissions were 27,541, 27,559, and 25,563, for the fiscal years ending September 30, 2016, 2015 and 2014, respectively. Total acute care admissions for fiscal year 2016 were unchanged compared to fiscal year 2015 following an 8% increase during fiscal 2015 compared fiscal 2014. Emergency room visits have increased year over year during each of the three most recently completed fiscal years. The rate of growth in emergency room visits has slowed, as expected, after a substantial increase in visits subsequent to the opening of the free-standing emergency center in August 2013. The Northeast Emergency Center ("NE-EC") is conveniently located at the intersection of major north-south and east-west arterial roads in the northern portion of Tallahassee. The NE-EC has continues to contribute to reduced patient wait times and improved patient satisfaction with emergency visits.

The number of surgical cases performed at the Hospital has increased 4.5% during fiscal year 2016 compared to fiscal year 2015. There was a slight decrease of 0.5% in cases occurring in fiscal year 2015 compared to fiscal year 2014. The slight decrease in cases during fiscal year 2015 compared to fiscal year 2014 was attributable to the impact of the opening of Red Hill Surgical Center, LLC ("RHSC"), a multi-specialty ambulatory surgery center on the main campus of the Hospital. TMH owns 51% of RHSC. In addition, TMH owns 51% of Tallahassee Neurological Pain Management, LLC ("TNPMASC"), an ambulatory surgery center that specializes in pain management located, approximately 2.5 miles from the main campus. The remaining portions of RHSC and TNPMASC are owned by surgeons who are members of the Hospital medical staff. Prior to the opening of RHSC and TNPMASC, the partner surgeons of both ambulatory surgery centers performed the vast majority of their surgical cases at the Hospital. The opening of these two ambulatory surgery centers provided immediate relief for over-burdened operating suites at the Hospital. The utilization of existing operating suites is severely constrained and inefficient due to a lack of space required to effectively schedule and manage the increasing complex surgical procedures performed at the Hospital. Surgical caseload capacity will improve substantially upon completion of construction of the M.T. Mustian Center due to design efficiencies of the new operating suites, standardization of patient flow and preparation, standardization of supply management and improvements in pre-admission testing and block scheduling. Outpatient surgeries will continue to be performed, as appropriate, at the two jointly owned ambulatory centers. Inpatient surgical cases and complex outpatient surgical cases will continue to be performed in the Hospital.

Tallahassee Memorial HealthCare, Inc. and Subsidiaries

September 30, 2016, 2015 and 2014

Total operating expenses as a percentage of total revenues, gains and other support has remained relatively constant at 93.2%, 93.1%, and 93.5% for the fiscal years ending September 30, 2016, 2015 and 2014, respectively. During the most recently completed fiscal year, changes in expenses are primarily attributed to: (a) an increase in required reserves for the self insured retention of professional & general liability insurance; (b) costs incurred to continue implementation and enhancement of electronic medical records including provider documentation, order entry modules, cancer services module, and expansion of the ambulatory clinic software modules; (c) drug expense inflation due to continued price increases by manufacturers coupled together with growth in cancer related services including infusion therapy; (d) supply costs related to growth in complex surgical caseload; and (e) continued use of contract labor to supplement staff in information services and health information management departments related to software installations, conversion to ICD-10 and other regulatory requirements. Labor costs have improved to 45.5%, 46.5%, and 48.1% of total revenues, gains and other support for the fiscal years ending September 30, 2016, 2015 and 2014, respectively. The management team remains focused on productivity metrics and the number of full-time equivalents and has adequate controls in place to maintain appropriate, cost-effective staffing.

Through a strategic planning process which involved many constituents, TMH recognized the need and developed plans to modernize its operating suites and adult intensive care units. The planning process included in-depth participation and input from physicians, nurses, clinical staff, outside consultants in planning and design, patients and family members. The result of this planning effort is the proposed construction of a multi-story 350,000 square foot addition (the “Project”) which will be located at the southeast corner of the TMH campus and directly connected to the existing Hospital.

The Project will contain: (a) 28 operating suites which will replace all existing operating suites, (b) four interventional suites for neurosurgical and vascular procedures and (c) 72 adult medical/surgical intensive care beds, of which 60 will be used upon opening of the Project, with shelled-in space for the remaining 12 beds. The Project will be designed to accommodate future additions of operating suites and intensive care beds when the need arises. The Project will also house all the necessary support services for the operating suites and the intensive care beds, such as preadmission testing, perioperative services, post-anesthesia care unit, sterile processing services, blood bank, respiratory therapy, CT imaging, pharmacy, and materials management.

The Project is currently under construction and proceeding as expected within budgeted cost and timelines.

The Project includes construction of the building addition, acquisition of operating suite and intensive care equipment, and a variety of required enabling projects to prepare the site (removal of existing buildings, relocation of infrastructure, improvements to storm water conveyance systems, roadway and access improvements and relocation of certain access points to existing facilities.) The anticipated final cost of the Project, including capitalized interest, is approximately \$275 million. Proceeds from City of Tallahassee, Florida Health Facilities Revenue Bonds, Series 2016A and Series 2016B are used to finance the cost of the project together with an equity contribution by the Hospital.

Other future capital plans include ordinary and necessary annual replacements of existing equipment and acquisition of new equipment as technology changes. Routine capital needs will be funded from operating cash flow and no additional indebtedness is planned at this time.

Tallahassee Memorial HealthCare, Inc. and Subsidiaries
September 30, 2016, 2015 and 2014

Historical Utilization

The following table summarizes certain operating and utilization statistics of TMH for fiscal years ending September 30, 2016, 2015 and 2014:

	Fiscal Year Ended September 30,		
	<u>2016</u>	<u>2015</u>	<u>2014</u>
Licensed Acute Beds (Adult)	659	659	659
Skilled Nursing Beds	<u>113</u>	<u>113</u>	<u>113</u>
Total Licensed Beds	772	772	772
Acute Patient Days	125,310	124,733	116,673
Newborn Patient Days	7,586	7,711	7,588
Acute Discharges	27,561	27,539	25,503
Adjusted Acute Discharges	54,916	53,585	50,002
Acute Average Length of Stay (Days)	4.55	4.53	4.56
Medical/Surgical Patient Days	90,963	90,397	82,168
Medical/Surgical Discharges	20,331	19,874	18,100
Medical/Surgical Average Length of Stay (Days)	4.47	4.55	4.53
Skilled Nursing Unit Patient Days	15,504	14,458	14,042
Average Daily Patient Census:			
Acute Care	342.4	341.7	319.7
Skilled Nursing Unit	42.4	39.6	38.5
Occupancy (Licensed beds):			
Acute Care	52%	52%	49%
Skilled Nursing Unit	38%	35%	34%
Deliveries	3,750	3,790	3,704
Operating Room - Number of Cases:			
Inpatient	7,285	6,824	6,860
Outpatient	<u>17,798</u>	<u>17,161</u>	<u>17,273</u>
Total - Number of Operations	25,083	23,985	24,133
Emergency Room Outpatient Visits	108,592	106,088	95,289
Urgent Care Visits	29,914	29,633	26,767
Hospital Outpatient Visits	154,386	147,315	143,101
Physician Group wRVUs	777,664	707,455	618,688
Average no. of FT equivalent employees	4,006	4,060	3,808
Medicare Case Mix	1.7562	1.6235	1.6827

Tallahassee Memorial HealthCare, Inc. and Subsidiaries
September 30, 2016, 2015 and 2014

Sources of Patient Service Revenue

Payments are made to TMH by patients, by various issuing organization (including self-insured employers), and by the federal and state governments under Medicare, Medicaid and other programs. TMH is certified by the State of Florida to participate in the Medicaid Program and by the U.S. Department of Health Services to participate in the Medicare program. The approximate percentages of gross patient charges for the fiscal years ending September 30, 2016, 2015 and 2014:

	Fiscal Year Ended September 30,		
	2016	2015	2014
	<u>Charges</u>	<u>Charges</u>	<u>Charges</u>
Medicare	41.2%	40.5%	40.9%
Medicaid	11.6%	12.1%	12.6%
HMO, Commercial	35.0%	35.6%	34.4%
Self-Pay	10.7%	10.0%	10.2%
Other	1.6%	1.8%	1.9%
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TOTAL	100.0%	100.0%	100.0%

Tallahassee Memorial HealthCare, Inc. and Subsidiaries
September 30, 2016, 2015 and 2014

Historical Coverage of Maximum Annual Debt Service

The following table sets forth the historical maximum annual debt service coverage ratio of TMH for the fiscal years ended September 30, 2016, 2015 and 2014. Such information should be considered in conjunction with the consolidated financial statements and the notes thereto. The following information includes the results of the entities that are not members of the Obligated Group and is presented for the financial information only and does not necessarily correspond to the coverage requirements of the Master Indenture; however, if the calculations had been made in accordance with the Master Indenture, the results would not have been materially different from those presented below because the members of the Obligated Group are substantially similar to the entities whose results are included below.

	Fiscal Year Ended September 30,		
	<u>2016</u>	<u>2015</u>	<u>2014</u>
Excess of Revenues Over Expenses	\$ 43,870,318	\$ 39,218,634	\$ 34,222,813
Add: Depreciation and Amortization	33,150,947	29,893,355	28,012,796
Add: Interest Expense	6,351,262	7,599,500	8,431,901
Change in fair value of swaps	(1,101,162)	(1,423,936)	(614,913)
Net Revenues Available for Debt Service	<u>\$ 82,271,365.00</u>	<u>\$ 75,287,553.00</u>	<u>\$ 70,052,597.00</u>
Maximum Annual Debt Service	23,087,453.00	12,609,603.00	12,799,547.00
Maximum Annual Debt Service Coverage Ratio	3.56x	5.97x	5.47x

Tallahassee Memorial HealthCare, Inc. and Subsidiaries

September 30, 2016, 2015 and 2014

Capitalization

The table below sets forth the capitalization of TMH as of September 30, 2016, 2015 and 2014:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Health Facilities Revenue Refunding Bonds, Series 1992B, interest of 6% at September 30, 2014, final maturity December 2015.	\$ -	\$ -	\$ 6,090,000
Health Facilities Revenue Bonds, Series 2000, interest of 6.25% to 6.375% at September 30, 2014, final maturity December 2030.			100,100,000
Healthcare Facilities Subordinated Revenue Bonds, Series 2008, interest of 9.3% at September 30, 2016 and 2015, final maturity June 2028.	600,000	600,000	600,000
Healthcare Facilities Revenue Refunding Bonds, Series 2015A, interest of 4.0% to 5.0% at September 30, 2016, final maturity December 2044.	107,290,000	107,290,000	-
Healthcare Facilities Revenue Bonds, Series 2016A, interest of 4.0% to 5.0% at September 30, 2016, final maturity December 2055.	150,000,000	-	-
Healthcare Facilities Revenue Bonds, Series 2016B, interest of 5.25 % at September 30, 2016, final maturity December 2051.	100,000,000	-	-
Note payable, principal and interest installments of \$42,500 due quarterly with an interest rate of 175 basis points above the LIBOR base rate which was 1.98% at September 30, 2014	-	-	735,149
Capital lease obligations	21,688,393	21,882,389	22,166,090
	<u>\$ 379,578,393</u>	<u>\$ 129,772,389</u>	<u>\$ 129,691,239</u>
Add net amortized bond premium and bond issue cost and (deduct net bond discount and bond issuance cost)	21,594,085	2,593,461	(1,877,803)
Total Long-Term Debt	\$ 401,172,478	\$ 132,365,850	\$ 127,813,436
Less: Current portion	(3,076,809)	(407,579)	(4,133,700)
Long-Term portion	\$ 398,095,669	\$ 131,958,271	\$ 123,679,736
Total Unrestricted Net Assets	336,960,134	293,213,258	297,215,679
Total Capitalization	<u>\$ 735,055,803</u>	<u>\$ 425,171,529</u>	<u>\$ 420,895,415</u>
Net Long-Term Debt as a Percentage of Total Capitalization	54.2%	31.0%	29.4%

Tallahassee Memorial HealthCare, Inc. and Subsidiaries
September 30, 2016, 2015 and 2014

Liquidity

The table below presents TMH's Days Cash on Hand at September 30, 2016, 2015 and 2014.

	<u>Fiscal Year Ended September 30,</u>		
	2016	2015	2014
Unrestricted Cash and Investments	\$275,794,226	\$254,766,789	\$196,937,306
Total Expenses	620,292,807	561,863,766	513,829,270
Less: Depreciation & Amortization	<u>32,063,491</u>	<u>28,806,903</u>	<u>26,889,388</u>
Subtotal	\$588,229,316	\$533,056,863	\$486,939,882
Daily Expense	\$1,607,184	\$1,460,430	\$1,334,082
Unrestricted Days Cash	172	174	148