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UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Financial Statements

December 31, 2016 and 2015

(With Independent Auditors' Reports Thereon)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

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Independent Auditors' Report

The Board of Directors
University Hospitals Health System, Inc.:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of University Hospitals Health System, Inc. and subsidiaries (the System), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and 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 U.S. generally accepted accounting principles; 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 auditors' 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 University Hospitals Health System, Inc. and subsidiaries as of December 31, 2016 and 2015, the results of their operations and changes in net assets, and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

March 22, 2017
Cleveland, Ohio

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2016 and 2015

(In thousands of dollars)

Assets		**2016**	**2015**
Current assets:			
Cash and cash equivalents	$	264,527	201,457
Patient accounts receivable, less allowance for doubtful accounts of $61,653 in 2016 and $65,140 in 2015		550,057	457,431
Other receivables		71,872	91,418
Other current assets		149,155	145,943
Total current assets		1,035,611	896,249
Investments		1,528,680	1,485,826
Property and equipment, net		1,618,013	1,581,143
Other assets:			
Investments in affiliates		91,163	84,666
Beneficial interest in Foundations		157,985	153,285
Perpetual trusts		191,015	188,822
Other		147,549	158,759
Total other assets		587,712	585,532
Total assets	$	4,770,016	4,548,750

(Continued)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2016 and 2015

(In thousands of dollars)

Liabilities and Net Assets		**2016**	**2015**
Current liabilities:			
Current installments of long-term debt	$	23,190	24,827
Accounts payable and accrued expenses		421,235	406,334
Other current liabilities		73,601	103,464
Estimated amounts due to third-party payors		24,725	31,165
Total current liabilities		542,751	565,790
Long-term debt, less current installments		1,272,085	1,283,215
Other liabilities		740,234	633,187
Total liabilities		2,555,070	2,482,192
Net assets:			
Unrestricted		1,508,451	1,372,564
Temporarily restricted		339,121	334,026
Permanently restricted		367,374	359,968
Total net assets		2,214,946	2,066,558
Total liabilities and net assets	$	4,770,016	4,548,750

See accompanying notes to consolidated financial statements.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2016 and 2015

(In thousands of dollars)

		2016	2015
Unrestricted revenues:			
Net patient service revenue	$	3,659,165	3,176,364
Provision for bad debts		(89,142)	(76,970)
Net patient service revenue less provision for bad debts		3,570,023	3,099,394
Other revenue		219,549	187,548
Total unrestricted revenues		3,789,572	3,286,942
Expenses:			
Salaries, wages, and employee benefits		2,174,744	1,876,009
Purchased services		278,476	220,497
Patient care supplies		609,902	522,309
Other supplies		52,507	48,332
Insurance		42,273	40,342
Other		335,560	313,376
Depreciation and amortization		140,616	121,460
Interest		47,408	46,761
Special charges		3,764	4,293
		3,685,250	3,193,379
Net operating income		104,322	93,563
Nonoperating revenues (expenses):			
Investment income		25,233	43,055
Other-than-temporary decline in investments		(5,368)	(6,929)
Change in fair value of derivative instruments		10,456	(2,991)
Loss on extinguishment of debt		(8,156)	(314)
Gain on disposition of business unit		4,039	—
Member substitutions		—	100,883
Excess of revenues over expenses	$	130,526	227,267

(Continued)

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2016 and 2015

(In thousands of dollars)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Net assets at December 31, 2014	$ 1,138,737	265,566	355,959	1,760,262
Excess of revenues over expenses	227,267	—	—	227,267
Investment income	—	8,764	—	8,764
Other support and revenue	—	36,998	7,455	44,453
Change in beneficial interest in Foundations and perpetual trusts	—	755	(8,837)	(8,082)
Net assets released from restrictions used for operations	—	(29,898)	—	(29,898)
Change in net unrealized gains and (losses) on other-than-trading securities	(40,632)	(344)	—	(40,976)
Change in joint venture unrestricted net assets	(66)	—	—	(66)
Pension liability adjustment	39,867	—	—	39,867
Net assets released from restrictions for acquisition of property and equipment	7,276	(7,276)	—	—
Contributed capital	115	—	—	115
Member substitutions with restrictions	—	59,461	5,391	64,852
Increase in net assets	233,827	68,460	4,009	306,296
Net assets at December 31, 2015	1,372,564	334,026	359,968	2,066,558
Excess of revenues over expenses	130,526	—	—	130,526
Investment income	—	8,173	—	8,173
Other support and revenue	—	29,489	4,524	34,013
Change in beneficial interest in Foundations and perpetual trusts	—	4,011	2,882	6,893
Net assets released from restrictions used for operations	—	(32,646)	—	(32,646)
Change in net unrealized gains and (losses) on other-than-trading securities	31,929	214	—	32,143
Pension liability adjustment	(30,993)	—	—	(30,993)
Net assets released from restrictions for acquisition of property and equipment	4,146	(4,146)	—	—
Contributed capital	279	—	—	279
Increase in net assets	135,887	5,095	7,406	148,388
Net assets at December 31, 2016	$ 1,508,451	339,121	367,374	2,214,946

See accompanying notes to consolidated financial statements.

UNIVERSITY HOSPITALS HEALTH SYSTEM, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2016 and 2015

(In thousands of dollars)

		2016	2015
Operating activities:			
Increase in net assets	$	148,388	306,296
Adjustments to reconcile increase in net assets to net cash provided by operating activities:			
Depreciation and amortization		140,616	121,460
Amortization of bond premium, discount, and financing costs		(1,513)	261
Provision for bad debts		89,142	76,970
Loss on extinguishment of debt		8,156	314
Other than temporary decline in investments		5,368	6,929
Change in beneficial interest in Foundations and perpetual trusts		(6,893)	8,082
Change in net unrealized investment gains and losses		(32,143)	40,976
Net realized gains and losses on sale of investments		(2,838)	(18,400)
Pension liability adjustment		30,993	(39,867)
Net change attributable to investments in joint ventures		(5,938)	(1,038)
Member substitutions		—	(165,735)
Restricted revenue and investment income		(21,203)	(17,241)
Gain on termination of interest rate swap		(980)	(1,030)
Gain on disposal of business unit		(4,039)	—
Net change in operating assets and liabilities:			
Patient accounts receivable		(181,701)	(120,410)
Other current assets		16,577	(12,339)
Accounts payable, accrued expenses, and other current liabilities		(14,591)	(9,369)
Other assets and liabilities		34,272	91,012
Net cash provided by operating activities		201,673	266,871
Investing activities:			
Acquisition of property and equipment		(179,031)	(140,812)
Change in property and equipment payables		(123)	2,652
Proceeds from sales of investments		2,814,030	3,006,157
Purchases of investments		(2,827,271)	(3,179,853)
Net proceeds from disposal of business unit		4,042	—
Member substitution cash payments		—	(3,337)
Other acquisitions		—	(9,000)
Net cash used in investing activities		(188,353)	(324,193)
Financing activities:			
Proceeds from restricted revenue and investment income		21,203	17,241
Repayment of long-term debt		(310,431)	(149,281)
Proceeds from issuance of long-term debt		300,074	210,510
Bond issuance costs		(1,948)	(1,104)
Proceeds from revolving credit borrowing		40,000	—
Proceeds from termination of interest rate swap		980	1,030
(Decrease) increase in treasury service agreement		(128)	4,515
Net cash provided by financing activities		49,750	82,911
Increase in cash and cash equivalents		63,070	25,589
Cash and cash equivalents at beginning of year		201,457	175,868
Cash and cash equivalents at end of period	$	264,527	201,457

See accompanying notes to consolidated financial statements.

(1) Organization and Principles of Consolidation

University Hospitals Health System, Inc. (the System) is the parent of various corporations involved in the delivery of healthcare services, including a network of physicians, outpatient centers, hospitals, wellness, occupational health, skilled nursing, elder health, rehabilitation, and home care services that operate in the Northeast Ohio region. University Hospitals Cleveland Medical Center (UHCMC) is the System's major subsidiary. The System provides certain management and planning services to its subsidiaries. The System also has joint venture investments in other healthcare systems (note 13), which are accounted for under the equity method.

The consolidated financial statements include the accounts of the System and its subsidiaries. All significant intercompany transactions have been eliminated in the consolidated financial statements.

On June 1, 2015, November 2, 2015, and November 12, 2015, the System became the sole corporate member of Robinson Health System (now known as University Hospitals Portage Medical Center (Portage)), St. John Medical Center (now known as University Hospitals St. John Medical Center (St. John)), and Samaritan Regional Health System (now known as Samaritan Medical Center (Samaritan)), respectively, through member substitution agreements (note 21).

(2) Summary of Significant Accounting Policies

(a) Cash and Cash Equivalents

The System considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents, excluding investments. The carrying amount of cash and cash equivalents approximates fair value.

(b) Concentrations of Credit Risk

Financial instruments that potentially subject the System to concentrations of credit risk consist principally of cash, cash equivalents, and patient accounts receivable. The System invests its cash equivalents in highly rated financial instruments including time deposits, U.S. Treasury bonds and notes, government-backed mortgage securities, and corporate notes with original maturities of three months or less.

The System's concentration of credit risk relating to patient accounts receivable is limited by the diversity and number of the System's patients and payors. Patient accounts receivable consist of amounts due from governmental programs, commercial insurance companies, other group insurance companies, and private pay patients. Combined revenues from the Medicare and Medicaid programs accounted for approximately 45% and 47% of the System's net patient service revenue for the years ended December 31, 2016 and 2015, respectively. Excluding governmental programs, no one payor source represents more than 15% of the System's patient accounts receivable. The System maintains an allowance for doubtful accounts based on the expected collectability of patient accounts receivable considering historical collection experience and other economic factors.

(c) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value on the consolidated balance sheets and are classified as other-than-trading securities. Investment income, including realized gains and losses, is reported as investment income in nonoperating revenue on the consolidated statements of operations and changes in net assets. Unrealized gains and losses on investments recorded at fair value are reported within net assets. Interest and dividend income on temporarily and permanently restricted investments is recorded according to the donor's intentions and as temporarily restricted investment income within the consolidated statements of operations and changes in net assets.

The System's alternative investments, which include private equity, real estate, hedge funds, and distressed debt investments, are reported at fair value as estimated and reported by general partners, based upon the underlying net asset value ("NAV") of the fund or partnership as a practical expedient. Adjustment to NAV is required when the System expects to sell the investment at a value other than NAV. The cost method is used for certain alternatives when the System owns less than 3% of the investment. Interest and dividends, unrealized and realized gains and losses from these investments are recorded within nonoperating revenues on the consolidated statements of operations and changes in net assets as investment income.

Investments, in general, are exposed to various risks such as interest rate, credit and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term, and that such changes could materially affect the amounts reported in the consolidated financial statements.

Other-than-temporary declines result from decreases in the fair market values of debt, equity, and alternative investments below the cost basis in these securities. Other-than-temporary declines for unrestricted investments are recorded in the consolidated statements of operations and changes in net assets. Other-than-temporary losses for temporarily and permanently restricted net assets are recorded within temporarily restricted investment income in the consolidated statements of operations and changes in net assets. Other-than-temporary declines also result in a new cost basis for the investment.

(d) Costs of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Capitalized interest totaled $986 and $1,164 for the years ended December 31, 2016 and 2015, respectively. Deferred financing costs are capitalized when incurred, and then amortized on a straight-line basis during the period in which the debt is outstanding. Deferred financing costs totaled $11,115 and $11,158 for the years ended December 31, 2016 and 2015 and are reported as a component of long-term debt on the consolidated balance sheet (see note 2(q)).

(e) Property and Equipment and Other Long-Lived Assets

Additions and improvements to property and equipment are capitalized at cost. Costs for maintenance and repairs are charged to expense as incurred. Depreciation on plant and equipment is computed on the straight-line basis over the estimated useful lives of the respective assets. Buildings and improvements are depreciated over estimated useful lives ranging generally from 5 to 50 years. Leasehold improvements are depreciated over the lesser of the life of the asset or the term of the lease. Estimated useful lives of equipment vary generally from 3 to 20 years.

(In thousands of dollars)

Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. An impairment loss is recognized when the carrying value of the asset exceeds its fair value. There were no impaired assets identified in 2016 or 2015.

(f) Gifts, Private Grants, Bequests, and Pledges

Unconditional donor promises to give cash, marketable securities, and other assets to the System are reported at fair value, net of fund-raising costs, and discounted to present value at the date the promise is received to the extent estimated to be collectible. Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. The System has conditional donor promises to give of $204,768 and $189,544 at December 31, 2016 and 2015, respectively, which have not been recognized as assets or revenues in these accompanying consolidated financial statements. Unrestricted contributions are included in the consolidated statements of operations and changes in net assets as unrestricted other revenue. Contributions that are received with donor restrictions that limit the use of the donated asset are reported as either temporarily or permanently restricted in the consolidated statements of operations and changes in net assets as other support and revenue. When the donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is met, temporarily restricted nets assets are transferred to unrestricted net assets.

Gifts, private grants, and bequests that have been received from various corporations, foundations, and individuals for the years ended December 31, 2016 and 2015 are reported as follows:

		2016	2015
Unrestricted	$	2,088	1,857
Temporarily restricted		29,489	36,998
Permanently restricted		4,524	7,455
	$	36,101	46,310

Pledges are recorded as receivables in the year made and reported as either temporarily or permanently restricted in the consolidated statements of operations and changes in net assets as other support and revenue. Pledges due in less than one year from the balance sheet date are classified as other current assets and all other pledges are classified as other long-term assets on the consolidated balance sheets.

(In thousands of dollars)

Outstanding pledges receivable from various corporations, foundations, and individuals are recorded at their net present value. The balances at December 31, 2016 and 2015 are as follows:

		2016	2015
Pledges due:			
In less than one year	$	43,128	47,420
In one year to five years		53,108	63,868
In more than five years		37,899	38,650
		134,135	149,938
Discount		(11,197)	(12,148)
Allowance for doubtful pledges		(2,952)	(3,024)
	$	119,986	134,766

In 2006, the System entered into a 50-year affiliation agreement with Case Western Reserve University (CWRU) School of Medicine with the primary goal of supporting innovative, high-quality programs in medical education, research, and clinical care. In order to meet this goal, the parties collaborate on many clinical and academic programs and jointly recruit and fund clinical chairs and faculty.

In accordance with the affiliation agreement, every ten years the System and the CWRU School of Medicine will conduct a review of this affiliation to better facilitate the advancement of each party's mission and the collective goals of both organizations. In 2016, the System and CWRU School of Medicine signed a new amended agreement.

(g) Government Grants

Amounts received from government agencies are reported in the consolidated statements of operations and changes in net assets as unrestricted other revenue. Grants revenue totaled $9,531 and $9,399 for the years ended December 31, 2016 and 2015, respectively.

(h) Charity Care and Provision for Bad Debts

Throughout the admission, billing, and collection processes, certain patients are identified by the System as qualifying for charity care. The System provides care to these patients without charge or at amounts less than its established rates. Charity care includes those patients required to be identified in connection with the System's participation in the State of Ohio's Care Assurance Program. Under this Program, patients who are Ohio residents without any or adequate health insurance coverage and income at or below 100% of the federally defined poverty level are eligible to receive Medicaid covered services free of charge. The charges forgone for charity care provided by the System are not reported as net patient service revenue or as patient accounts receivable. The System accepts all patients covered by Medicare and Medicaid and treats patients requiring emergency care regardless of their ability to pay.

The uncompensated cost of charity care is estimated by applying an overall cost to charge ratio to the charges associated with patients who qualify for charity care. The estimated uncompensated costs of charity care are approximately $44,600 and $40,102 for the years ended December 31, 2016 and 2015, respectively.

In addition, the System provides services to other medically indigent patients under various state Medicaid programs. Such programs pay providers amounts that are less than the established charges for the services provided to the recipients. The uncompensated costs associated with these state programs is estimated as the total direct and indirect costs in excess of the payments received for the services provided. Services provided to Medicaid recipients (including Medicaid recipients who are participants in a Medicaid managed care plan) represented approximately 21% and 22% of the System's gross patient revenue for 2016 and 2015, respectively.

The System also provides other uncompensated care and community benefits. In furtherance of its exempt purpose to benefit the community, the System operates an inner city medical clinic to serve the healthcare needs of the community; operates emergency rooms open to the public 24 hours per day, 7 days per week; maintains research facilities for the study of disease and injuries; provides facilities for teaching and training various medical personnel; facilitates the advancement of medical and surgical education; provides community screenings for the detection of various diseases such as breast and colorectal cancer; sponsors cancer support groups; provides various community health education classes, speeches, television appearances, and articles published in newspapers and magazines; and undertakes other types of community benefit activities.

In addition to charity care and insufficient funding from the Medicaid program, there are significant losses related to self-pay patients who fail to make payment for services rendered or insured patients who fail to remit co-payments and deductibles as required under applicable health insurance arrangements. The provision for bad debts represents revenues for services provided that are deemed to be uncollectible. Provision for bad debts totaled $89,142 and $76,970 for the years ended December 31, 2016 and 2015, respectively.

(i) Excess of Revenues over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets, which, consistent with industry practice, are excluded from excess of revenues over expenses, include unrealized gains and losses on other-than-trading securities (except declines in fair value that management has determined to be other than temporary, which are reported as nonoperating losses), certain changes in joint venture net assets, assets acquired using funds restricted by the donor for the purpose of acquiring such assets, contributed capital, and adjustments for pension accounting (note 12).

(j) Derivative Financial Instruments

Derivative financial instruments are utilized by the System to manage: (i) interest rate risk; (ii) the fixed and floating interest rate mix of the System's total debt portfolio; and (iii) related overall cost of borrowing. The interest rate swap agreements involve the periodic exchange of payments without the exchange of the notional amount upon which the payments are based. The System does not use derivative financial instruments for trading purposes. The related amount of payables to counterparties under interest rate swap agreements is included in noncurrent other liabilities and the related amount of receivables from counterparties under swap agreements is included in noncurrent other assets on the consolidated balance sheets (note 9).

Derivative financial instruments are recorded on the consolidated balance sheets at their respective fair value. The interest rate swap agreements are not designated as hedging instruments. Gains and losses on derivative financial instruments are recorded in the change in fair value of derivative instruments within the consolidated statements of operations and changes in net assets. The net amount paid or received under the swap agreements is recorded as interest expense in the consolidated statements of operations and changes in net assets.

The System minimizes credit risk related to derivative financial instruments by requiring high credit standards for its counterparties and periodic settlements. The counterparties to these contractual arrangements are financial institutions that carry investment-grade credit ratings with which the System also has other financial relationships. The System is exposed to credit loss in the event of nonperformance by these counterparties. To mitigate credit exposure, the swap agreements contain certain collateral provisions applicable to both the System and the counterparties.

(k) Income Taxes

The System and most of its subsidiaries, including UHCMC, are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (Code) and are exempt from federal income taxes pursuant to Section 501(a) of the Code. The System also has certain subsidiaries that are taxable for federal income tax purposes (note 18).

(l) Costs Expected to Be Incurred in Connection with a Loss Contingency

Liabilities for asserted or unasserted claims and assessments are recorded when an unfavorable outcome of a matter is deemed to be both probable and the loss contingency is reasonably estimable.

(m) Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles (GAAP) 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.

(n) Electronic Health Record Incentive Program

The Medicaid and Medicare Electronic Health Records (EHR) Incentive Programs (the Programs) provide incentive payments to eligible hospitals and professionals as they adopt, implement, upgrade, or demonstrate meaningful use of certified EHR technology in their first year of participation and demonstrate meaningful use for up to five remaining participation years. The System recognizes revenue related to the Programs when there is reasonable assurance that the System will comply with the conditions set forth by Medicare and Medicaid and the System will receive the Programs' incentive payments. For the years ended December 31, 2016 and 2015, the System recognized approximately $6,750 and $11,813, respectively, as other revenue related to Medicaid and Medicare EHR incentives, which have been received or are expected to be received based on certifications prepared by management under the appropriate attestation guidelines.

(o) Treasury Service Agreement

The System included amounts due to a third party financing company for the use under a Supplemental Treasury Services Agreement (Agreement), entered into during 2013, within accounts payable in the accompanying consolidated balance sheets. Cash flows related to the Agreement are classified as financing activities in the consolidated statements of cash flows. The Agreement is a $70,000 unsecured trade payables and corporate card float program that is noninterest bearing and is not collateralized. The Agreement includes customary covenants as well as customary events of defaults. The amounts outstanding on the Agreement fluctuate on a daily basis, but as of December 31, 2016 and 2015, the amount outstanding included within accounts payable was $62,403 and $62,530, respectively. The System incurred no interest under this Agreement for the years ended December 31, 2016 and 2015.

(p) Affordable Care Act

The Patient Protection and Affordable Care Act of 2010 (the Affordable Care Act), enacted in March 2010, has changed and will continue to make broad-based changes to the U.S. health care system which could significantly affect the U.S. economy and which the System expects will continue to impact the System's business operations and financial results. Since its enactment in 2010, key component of the Affordable Care Act have been phased in, including health insurance exchanges, new Medicare products, and the individual coverage mandate. Although the Affordable Care Act is to be phased in through 2018, many significant changes have occurred and are expected to occur in the future. The System continues to analyze the Affordable Care Act and other potential legislative changes to assess its effects on current and projected operations, financial performance, and financial condition.

(q) Adopted Accounting Standards

In May 2015, the Financial Accounting Standards Board ("FASB") issued guidance relating to disclosures for investments that calculate net asset value ("NAV") per share or its equivalent. Accounting Standards Codification ("ASC") Topic 820, Fair Value Measurements, permits reporting entities, as a practical expedient to measure the fair value of certain investments using the NAV per share of the investment. This amendment removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the NAV per share practical expedient. The System adopted this guidance on January 1, 2016. As a result of this adoption, $352,141 of investments and $395,909 in defined benefit pension plan assets measured at NAV at December 31, 2016 ($300,384 in investments and $329,063 in defined benefit pension plan assets at December 31, 2015) that are valued using net asset value as a practical expedient are not categorized by level in the fair value hierarchy table (notes 5 and 12). This new guidance only amended disclosure requirements and did not have any impact on the consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update (ASU) 2015-03, Simplifying the Presentation of Debt Issuance Costs (Subtopic 835-30). ASU 2015-03 requires debt issuance costs related to a recognized debt liability to be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. The ASU did not change the measurement or recognition guidance for debt issuance costs. The System adopted this ASU on January 1, 2016. The adoption of this standard was applied retroactively to all periods presented, and had no impact on the System's consolidated results of operations or cash flows. As a result of this adoption, $11,158 of deferred debt issuance costs were reclassified from noncurrent other assets to a direct reduction of long-term debt at December 31, 2015.

(r) Reclassifications

Certain amounts included in the 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation.

(3) Net Patient Service Revenue

The System and certain of its subsidiary corporations have agreements with third party payors (e.g., Medicare, Medicaid, and commercial insurance carriers) that provide for payments and reimbursement at amounts different from the System's established billing rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third party payors. Adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as settlements are determined. Adjustments to amounts recorded in previous periods for the Medicare, Medicaid, and Champus/Tricare program resulted in net patient service revenue increasing by approximately $6,698 and $19,069 for the years ended December 31, 2016 and 2015, respectively.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The System believes that it is in compliance, in all material respects, with all applicable laws and regulations.

Patients' accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of patients' accounts receivable, the System analyzes its past history and identifies trends to estimate the appropriate allowance for doubtful accounts. Management regularly reviews data about the System's major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for doubtful accounts, if necessary (e.g., for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients, those with no third-party coverage, the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is written off against the allowance for doubtful accounts.

The System's allowance for uncollectible accounts was 88% and 97% of self-pay and known guarantor balance patient accounts receivable at December 31, 2016 and 2015, respectively. The System is still experience a rising in patient responsibilities due in part to high deductible and high co-pay insurance plans; during 2016, a higher percentage of uninsured patients were able to qualify for Medicaid than in past years. The System did not change its charity care or uninsured discount policies during fiscal year 2016 or 2015. The System does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

The System recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the System's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the System records a significant provision for bad debts related to uninsured patients in the period the services are provided. The percentage of patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), derived from these major payer sources as of December 31, 2016 and 2015 are as follows:

(In thousands of dollars)

	2016	2015
Third party	96%	96%
Self-pay	4	4
	100%	100%

(4) Net Assets

Temporarily restricted net assets are presented to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the System. Temporarily restricted gifts, which include unrestricted pledges, are recorded as an addition to temporarily restricted net assets in the period received. Temporarily restricted net assets are available for the following purposes and the amount of beneficial interest in Foundations at December 31, 2016 and 2015 are as follows:

		2016	2015
Capital expenditures	$	46,168	40,251
Education		7,431	6,250
Research		91,870	91,562
Patient care		61,308	68,582
Beneficial interest in Foundations		132,344	127,381
	$	339,121	334,026

Permanently restricted net assets consist of amounts held in perpetuity as designated by donors, including the System's portion of beneficial interests in several perpetual trusts. Investment income on temporarily and permanently restricted investments, including realized gains and losses, is recorded according to the donor intentions. Changes in unrealized gains and losses on investments are recognized directly in net assets.

Net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors. Net assets released from restrictions used for operations totaled $32,646 and $29,898 during 2016 and 2015, respectively. Net assets released from restrictions are recorded in other revenue in the consolidated statements of operations and changes in net assets. In addition, $4,146 and $7,276 in net assets were released from restriction for the acquisition of property and equipment in 2016 and 2015, respectively.

The System's endowment consists of 414 individual funds established for a variety of purposes. Endowments include both donor-restricted funds and funds designated by the Board of Directors (the Board) to function as endowments. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. The System's permanently restricted endowment funds are donor restricted, which totaled $135,849 and $129,036 at December 31, 2016 and 2015, respectively. Board designated funds are unrestricted and totaled $17,654 and $17,331 at December 31, 2016 and 2015, and are included within unrestricted investments.

(In thousands of dollars)

The System's investment policy establishes a limited number of investment pools with a specific purpose of aggregating various System funds' investments according to their risk tolerance. Asset allocation is reviewed quarterly with respect to: i) System tolerance for risk based on its financial condition and need for cash from investments to support operations; ii) expected asset class return, risk, and correlation characteristics; iii) changes in accounting guidance or tax law; and iv) changes in bond covenants or other restrictions. Management of the System is responsible to ensure the proper allocation of funds according to the specific needs, timing of cash flows, and risk tolerance of each fund.

The System's spending practices are intended to comply with the donor's wishes and meet all applicable laws and regulations including the Uniform Prudent Management of Institutional Funds Act. Spending must be for a purpose that is consistent with the documented intent of the donor. The System generally appropriates an amount not to exceed 5% of the endowment fund's fair value for annual spending subject to spending guidelines and restrictions per the System's policy. The fair value of the endowment fund is determined quarterly and averaged over a period of a rolling thirty-six months.

		Unrestricted (Board designated)	Temporarily restricted	Permanently restricted	Total
Endowment net assets, at December 31, 2014	$	17,330	31,107	121,687	170,124
Investment return:					
Investment income		—	493	—	493
Contributions		1	—	7,349	7,350
Appropriation of endowment assets for expenditure		—	(6,266)	—	(6,266)
Endowment net assets, at December 31, 2015		17,331	25,334	129,036	171,701
Endowment return:					
Investment income		323	9,158	—	9,481
Contributions		—	—	6,813	6,813
Appropriation of endowment assets for expenditure		—	(6,778)	—	(6,778)
Endowment net assets, at December 31, 2016	$	17,654	27,714	135,849	181,217

(5) Fair Value Measurements

The Financial Accounting Standards Board (FASB) establishes a hierarchy for ranking the quality and reliability of the information used to determine fair values. Assets and liabilities carried at fair value are to be disclosed according to the following three levels:

Level 1 – Unadjusted quoted prices for identical assets or liabilities in active markets. Level 1 yields the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2 – Observable inputs other than quoted prices in Level 1. Inputs such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar liabilities that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Unobservable inputs that are significant to the valuation of assets or liabilities and are supported by little or no market data. This includes discounted cash flow methodologies, pricing models, and similar techniques that use significant unobservable inputs.

The inputs used to fair value Level 1 instruments are unadjusted quoted prices derived from stock exchanges, and the Chicago Board of Trade. Level 1 instruments primarily consist of equities, exchange traded funds, and certain government securities.

Investments in Level 2 are primarily comprised of corporate bonds, bonds, asset-backed securities, fixed income mutual funds, and derivative financial instruments. Level 2 inputs primarily consist of quotes from independent pricing vendors based on recent trading activity, and other relevant information including matrix pricing, market corroborated pricing, yield curves, and other indices that are used when Level 1 inputs are not available.

Items classified as Level 3 in the fair value hierarchy include beneficial interest in Foundations, perpetual trusts, and excludes pledges of $122,938 and $137,790 at December 31, 2016 and 2015, respectively.

Investments that are measured at NAV per share are not categorized in the fair value hierarchy following tables.

(In thousands of dollars)

	Level 1	Level 2	Level 3	Total
December 31, 2016:				
Assets:				
Cash and cash equivalents	$ 264,527	—	—	264,527
Cash and cash equivalents – pooled with investments:				
Cash equivalents	49,991	—	—	49,991
Fixed income securities:				
Corporate bonds	—	192,894	—	192,894
Fixed income mutual funds	472,117	—	—	472,117
Government securities	103,515	57,552	—	161,067
Total fixed income securities	575,632	250,446	—	826,078
Equities, mutual and exchange traded funds:				
Domestic mutual and commingled funds	159,001	—	—	— 159,001
International mutual and commingled funds	48,699	—	—	— 48,699
Total equities, mutual and exchange traded funds	207,700	—	—	207,700
Deferred compensation assets - mutual funds	20,193	—	—	20,193
Beneficial interest in Foundations	—	—	157,985	157,985
Perpetual trusts	—	—	191,015	191,015
Interest rate swaps	—	5,031	—	5,031
Total	$ 1,118,043	255,477	349,000	1,722,520
December 31, 2016:				
Liabilities:				
Deferred compensation liabilities	$ 20,193	—	—	20,193
Interest rate swaps	—	61,198	—	61,198
Total	$ 20,193	61,198	—	81,391

(Continued)

(In thousands of dollars)

	Level 1	Level 2	Level 3	Total
December 31, 2015:				
Assets:				
Cash and cash equivalents	$ 201,457	—	—	201,457
Cash and cash equivalents – pooled with investments:				
Cash equivalents	96,871	85	—	96,956
Fixed income securities:				
Corporate bonds	—	171,713	—	171,713
Fixed income mutual funds	240,636	121,056	—	361,692
Government securities	197,744	49,551	—	247,295
Total fixed income securities	438,380	342,320	—	780,700
Equities, mutual and exchange traded funds:				
Domestic mutual and commingled funds	142,045	—	—	142,045
International mutual and commingled funds	70,653	—	—	70,653
Total equities, mutual and exchange traded funds	212,698	—	—	212,698
Deferred compensation assets - mutual funds	20,009	—	—	20,009
Benefical interest in Foundations	—	—	153,285	153,285
Perpetual trusts	—	—	188,822	188,822
Interest rate swaps	—	3,719	—	3,719
Total	$ 969,415	346,124	342,107	1,657,646
December 31, 2015:				
Liabilities:				
Deferred compensation liabilities	$ 20,009	—	—	20,009
Interest rate swaps	—	70,342	—	70,342
Total	$ 20,009	70,342	—	90,351

(In thousands of dollars)

The following table summarizes the System's investments at December 31, 2016 and 2015, for which NAV was used as a practical expedient to estimate fair value:

		2016	2015
Equities, mutual and exchange traded funds:			
Domestic mutual and commingled funds	$	41,299	34,579
International mutual and commingled funds		99,647	69,864
Total equities,		140,946	104,443
Alternative investments:			
Hedge funds		152,087	157,411
Real estate		24,989	17,048
Distressed debt		19,796	11,830
Private equity		14,323	9,652
Total alternative		211,195	195,941
Total	$	352,141	300,384

(In thousands of dollars)

The System evaluated transfers between levels based upon the nature of the financial instrument and size of the transfer relative to the total. For the years ended December 31, 2016 and 2015, there were no transfers into or out of Level 1, 2, or 3.

The System has various interest rate swaps as of December 31, 2016 and 2015, consisting of fixed-payor and fixed spread basis swaps. Fair values for the System's interest rate swaps are provided on a monthly basis by the System's independent financial advisor and counterparties. Monthly valuations are derived by pricing models, which use market inputs such as LIBOR, Securities Industry and Financial Markets Association (SIFMA) Swap Index, and bond coupon rates provided by various inter-broker sources. The resulting combination of market data feeds, specific structuring characteristics such as the amortization of notional amounts, effective dates, payment frequencies, day counts, credit risk, and indices, are factored into the pricing model to determine the fair market value of the System's interest rate swaps.

Foundations operate for the exclusive benefit of the System, and variance power was not explicitly given to the Foundations by the donors. Therefore, the System is required to record its beneficial interest in the net assets of the Foundations. The investment in the Foundations is categorized as a Level 3 item. The primary input utilized in calculating the Foundations' fair value is its net assets, which represents fair market valuation of certain equity, debt, and other instruments held by the Foundations. The System records 100% of the Foundations' net assets at approximate fair market value.

Permanently restricted net assets consist of amounts held in perpetuity as designated by donors, including the System's portion of beneficial interests in several perpetual trusts held and administered by others in which the System is an income beneficiary. Perpetual trusts are measured at fair value by the external trustee, which approximates the present value of expected future cash flows. Perpetual trusts utilize significant unobservable inputs determined by the external trustees in estimating fair value.

		Fair value measurements using significant unobservable inputs (Level 3)		
		Beneficial interest in Foundations	Perpetual trusts	Total
Balance at December 31, 2014	$	91,300	194,952	286,252
Member substitutions		58,946	4,991	63,937
Total change included in:				—
Temporarily restricted net assets		755	—	755
Permanently restricted net assets		2,284	(11,121)	(8,837)
Balance at December 31, 2015		153,285	188,822	342,107
Total change included in:				
Temporarily restricted net assets		4,011	—	4,011
Permanently restricted net assets		689	2,193	2,882
Balance at December 31, 2016	$	157,985	191,015	349,000

(In thousands of dollars)

(6) Investments

The fair value and the cost of investments at December 31, 2016 and 2015 are as follows:

	2016		2015	
	Carrying value	Cost	Carrying value	Cost
Cash and cash equivalents – pooled with investments	$ 49,991	49,994	96,956	96,880
Fixed income securities	826,078	831,216	780,700	787,402
Equities, mutual and exchange traded funds	348,646	308,015	317,141	308,969
Alternative investments	211,195	192,955	195,941	183,248
Total investments at fair value	1,435,910	$ 1,382,180	1,390,738	$ 1,376,499
Alternative investments (cost basis)	76,549		82,018	
Other	16,221		13,070	
Total investments	$ 1,528,680		1,485,826	

The System holds certain investments in fixed income securities including domestic and international corporate bonds; U.S. Treasuries, government, and agency bonds; non-U.S. sovereign debt; and emerging market debt. The System holds common and preferred stock including investments in small cap, mid cap, and large cap companies as well as in non-U.S. equities in developed and emerging markets.

Alternative investments include private equity, real estate, hedge funds, and distressed debt. These investments are made either directly or through various Fund-of-Funds, both of which are typically Limited Partnership structures. For the Fund-of-Funds investments, the System is invested in a Limited Partnership, which in turn utilizes its expertise to invest in underlying Limited Partnership Funds and make certain other investments.

The General Partner of each direct Limited Partnership determines the fair market valuation of its underlying holdings based on i) the nature and terms of each underlying investment, ii) market inputs, and iii) certain other relevant information. The General Partner of each Fund-of-Funds Limited Partnership determines the fair market valuation of its underlying Limited Partnership investments. These valuations are based primarily on the quarterly internal and annual audited consolidated financial statements of the underlying Limited Partnership Funds, which report net asset value based on i) the nature and terms of each underlying investment, ii) market inputs, and iii) certain other relevant information. The System undertakes various measures to validate that the reported net asset value approximates the fair market value. The determination of fair market values for the alternative investments requires the General Partners and System management to make estimates and assumptions about certain inputs and other factors that are inherently uncertain. These estimates are subjective and require judgment regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks.

(In thousands of dollars)

Assets categorized as alternative investments may be subject to liquidity restrictions such as gates. These gates prevent short-term liquidation of assets. Hedge funds may be redeemed at quarter-end requiring advanced notice ranging from 45 to 65 days, prior written notice subject to certain limitations that may be imposed by the General Partner of the fund without notice. Private equity and private real estate funds generally have contractual terms of 10 years or greater from the time the commitment to the fund is made. While distributions of capital during this term typically occur, many of these funds have provisions that allow the General Partner to extend the final term and suspend distributions. Distressed debt funds are typically 1-year to 5-year or 6-year to 10-year term structures, and although some of the funds offer liquidity, the fund documents allow the General Partner to suspend redemptions if they deem necessary. As a result of these contractual limitations on liquidity, these alternative assets are generally considered illiquid. Contractual liquidity terms of alternative investments at December 31, 2016 are as follows:

		Carrying value	Unfunded commitments
Less than 1 year, no contractual restrictions have been imposed	$	161,747	3,036
Subject to existing gates or restrictions		30,891	—
Limited Partnership Fund expiring in 1 – 5 years		32,213	6,867
Limited Partnership Fund expiring in 6 – 10 years		50,817	26,175
Limited Partnership Fund expiring in 11 – 12 years		12,076	24,514
Total alternative investments	$	287,744	60,592

The components and related restrictions of investments shown above are as follows:

		2016	2015
Unrestricted and board designated	$	1,290,176	1,262,873
Held by bond trustee		—	238
Swap collateral		5,875	6,516
Temporarily restricted		96,780	87,163
Permanently restricted		135,849	129,036
Total investments	$	1,528,680	1,485,826

(In thousands of dollars)

Investment income is comprised of the following for the years ended December 31, 2016 and 2015:

		2016	2015
Interest and dividend income:			
Unrestricted	$	22,395	24,655
Temporarily restricted		2,973	3,241
		25,368	27,896
Net realized gain (loss) on sales of securities:			
Unrestricted		(2,854)	17,062
Temporarily restricted		5,200	5,523
		2,346	22,585
Unrestricted – Gains from alternative investments		5,692	1,338
	$	33,406	51,819

(7) Property and Equipment

Property and equipment, at December 31, 2016 and 2015, are summarized below:

		2016	2015
Land and land improvements	$	165,143	158,945
Buildings and fixed equipment		1,852,750	1,779,024
Movable equipment and furnishings		1,271,540	1,174,177
Construction in progress		57,481	61,473
		3,346,914	3,173,619
Less accumulated depreciation		1,728,901	1,592,476
Net property and equipment	$	1,618,013	1,581,143

As of December 31, 2016, the System has made commitments on construction contracts, including information technology projects, of $33,193.

(8) Short-Term Borrowings and Long-Term Debt

The System’s $180,000 revolving credit commitment (the Credit Commitment), effective October 26, 2015, is a syndicated transaction with a maturity date of January 21, 2021. The Credit Commitment bears interest at various rates for short-term periods. For the year ended December 31, 2016, the average interest rate for borrowings under this credit line was 1.07%. As of December 31, 2016, there were $40,000 in borrowings under the Credit Commitment reported within noncurrent other liabilities in the consolidated balance sheet. The remaining available Credit Commitment is $140,000 at December 31, 2016.

The previous $100,000 revolving credit commitment was terminated by the System on October 26, 2015. This revolving credit agreement bore interest at various rates for short-term periods and prior to the termination was set to mature on September 29, 2016. The average interest rate for borrowings under this credit agreement was 0.99% for the year ended December 31, 2015.

(In thousands of dollars)

The System's $130,000 revolving credit facility (the Facility) effective October 4, 2011 expired on October 3, 2015. The Facility was a syndicated transaction and bore interest at various rates for short-term periods. There were no borrowings under the Facility in 2015.

A summary of long-term debt at December 31, 2016 and 2015 is as follows:

Series	Type	Weighted average interest rate% for the year ended December 31, 2016	Final maturity	Amount outstanding December 31 2016	2015
2016A	Fixed	3.59	2046	$ 229,725	—
2015A	Variable	0.69	2045	30,000	30,000
2015B	Variable	0.70	2045	30,000	30,000
2015C	Variable	0.69	2045	40,000	40,000
2015D	Variable	1.02	2046	78,550	78,550
2015E	Variable	1.02	2046	12,450	12,450
2014A	Fixed	3.69	2044	56,145	56,145
2014B	Variable	0.69	2045	30,000	30,000
2014C	Variable	1.02	2039	35,000	35,000
2013A	Fixed	4.65	2029	88,175	90,735
2013B	Variable	0.70	2033	30,000	30,000
2013C	Variable	0.52	2050	75,000	75,000
2013D	Variable	1.43	2040	—	23,350
2013E	Variable	1.43	2038	—	29,000
2012A	Fixed	4.73	2041	173,630	177,445
2012B	Variable	1.12	2019	14,190	20,455
2012C	Fixed	3.71	2042	55,825	55,825
2012D	Variable	1.08	2021	22,695	23,280
2010A	Fixed	4.82	2027	56,040	62,495
2010B	Variable	0.79	2035	50,000	50,000
2007A	Fixed	4.85	2041	52,445	289,460
2001	Variable	1.13	2033	10,000	10,000
Term loan	Variable	1.72	2029	50,700	—
Note payable	Fixed	1.95	2036	60,000	60,000
Other long-term debt				1,452	2,838
				1,282,022	1,312,028
Unamortized premium				26,309	9,229
Less:					
Unamortized discount				1,941	2,057
Deferred financing costs				11,115	11,158
Current installments				23,190	24,827
Long-term debt, less current installments				$ 1,272,085	1,283,215

The System is party to a Master Trust Indenture, amended and restated as of June 15, 1989 (the Indenture). The Revenue Bonds listed in the table above are secured by the Indenture and are general obligations of the Obligated Group. The Obligated Group consists of the System, UHCMC, University Hospitals Geauga Medical Center, University Hospitals Ahuja Medical Center, Inc., University Hospitals Parma Medical Center, University Hospitals Elyria Medical Center, and University Hospitals St. John Medical Center.

In March 2016, the System issued tax-exempt bonds totaling $229,725 with a premium of $19,649. The Series 2016A Bonds carry an average yield to maturity of 3.96%. The proceeds from these bonds were placed in escrow to refund $237,015 of the 2007A fixed-rate tax-exempt bonds.

In December 2016, the System entered into a term loan totaling $50,700. The term loan has a variable rate based on a set spread over a percent of LIBOR. Proceeds from the term loan were used to refund the Series 2013D and 2013E bonds and the remainder paid for cost of issuance.

In December 2015, the System issued tax-exempt bonds totaling $91,000. The debt is comprised of the 2015D and E bonds in respective amounts of $78,550 and $12,450. The Bonds have a variable rate based on a set spread over a percent of LIBOR. The System used proceeds of $90,611 to pay off a taxable revolving line of credit related to the member substitutions of University Hospitals St. John Medical Center and University Hospitals Samaritan Medical Center, with the remaining proceeds paying for the cost of issuance.

In October 2015, the System issued tax-exempt bonds totaling $100,000. The debt is comprised of the 2015A, B, and C bonds in respective amounts of $30,000, $30,000, and $40,000. The Series 2015A and C Bonds are variable rate debt determined daily by a remarketing agent with a term-out period of three years and maximum rate of 12% and 10%, respectively. The Series 2015B Bonds are variable rate debt determined weekly by a remarketing agent with a term-out period of two years and a maximum rate of 12%. The System used proceeds of $40,216 to pay off a taxable revolving line of credit related to the member substitution of University Hospitals Portage Medical Center, $21,125 to partially refund the 2010B Bonds, $37,316 for new capital projects, and the remainder paying for the cost of issuance.

In July 2015, the System drew an additional $20,000 on the 2014C bonds. The proceeds were used to refund the 2009C bonds. Proceeds of $2,078 from the 2009C debt reserve fund were used to pay down taxable revolving lines of credit related to the member substitution of University Hospitals Portage Medical Center.

A total of $85,000 of bonds could become due in 2017. This amount represents i) variable rate bonds totaling $75,000, which are backed by bank letters of credit and could become due in 2017 based on the repayment schedule of the bank letters of credit upon the failure to remarket these bonds and ii) $10,000 of variable rate bonds for which the System provides self-liquidity and is not backed by a letter of credit. The total that could become due in 2017 is offset by the remaining available borrowing capacity of $140,000 on the Credit Commitment, which is not due until January 21, 2021.

In connection with the issuance of the Series 2016A, 2015A, B, C, D, and E, 2014A, B, and C, 2013A and B, 2012A, B, C, and D, 2010A and B, and 2007A tax-exempt bonds by the Ohio Higher Educational Facility Commission (the Commission) for the benefit of the System, the System has leased to the Commission, and the Commission has subleased to the System the certain bond-financed assets. The System does not receive rental payments under its lease to the Commission and is required only to make rental payments to the Commission at the times and in the amounts sufficient to pay principal and interest on the outstanding tax-exempt bonds under its lease from the Commission. The lease agreements expire upon repayment of all indebtedness secured by the leases.

In connection with the issuance of the Series 2001 tax-exempt bonds by Cuyahoga County (the County) for the benefit of the System, the System has leased to the County, and the County has subleased to the System, certain healthcare facilities of the System. The System does not receive rental payments under its lease to the County and is required only to make rental payments to the County at the times and in the amounts sufficient to pay principal and interest on the outstanding tax-exempt bonds under its lease from the County. The lease agreements expire upon repayment of all indebtedness secured by the leases.

(In thousands of dollars)

During the term of the various agreements and leases, the System is required to make specified deposits with trustees to fund principal and interest payments due. The System is subject to certain restrictive covenants, including provisions relating to certain debt ratios, days cash on hand, and other matters. The System was in compliance with these debt covenants at December 31, 2016 and 2015.

Combined current aggregate scheduled maturities of long-term debt for the five years subsequent to December 31, 2016 are as follows: 2017 – $23,190; 2018 – $23,142; 2019 – $24,115; 2020 – $25,535; 2021 - $25,715; and 2022 and thereafter – $1,160,325.

The average interest rate included in the table above is the weighted average interest cost for the year ended December 31, 2016 for the 2001, 2010B, 2012B and D, 2013B, C, D, and E, 2014B and C, 2015A, B, C, D, and E Bonds, and Term Loan.

Cash paid for operating interest totaled $45,118 and $46,762 in 2016 and 2015, respectively.

(9) Interest Rate Swap Agreements

The System utilizes interest rate swaps to manage the overall cost of debt and risk profile related to its long-term debt. The swaps utilized include i) fixed-payor swaps, whereby the System receives a floating rate and pays a fixed rate designed to either hedge against rising interest rates or achieve a lower overall cost of debt relative to traditional fixed-rate structures and ii) basis swaps whereby the System receives a floating rate based on a taxable index (LIBOR) and pays a floating rate based on a tax-exempt index (SIFMA) designed to reduce interest costs associated with its traditional fixed rate debt. A summary of the System's interest rate swap agreements is as follows:

	Maturity	Year ended December 31, 2016		Notional value at December 31	
Swap type	date	System pays	System receives	2016	2015
Fixed-payer	2034	3.3610%	67% of 1-month LIBOR	$ 37,500	37,500
Fixed-payer	2034	3.4158%	67% of 1-month LIBOR	37,500	37,500
Basis	2028	SIFMA Index	67% of 1-month LIBOR + 0.4712%	25,000	25,000
Basis	2028	SIFMA Index	67% of 1-month LIBOR + 0.526%	25,000	25,000
Fixed-payer	2034	3.493%	67% of 1-month LIBOR	37,500	37,500
Fixed-payer	2034	3.455%	67% of 1-month LIBOR	37,500	37,500
Basis	2027	SIFMA Index	62.3% of 1-month LIBOR + 0.79%	----	42,500
Basis	2027	SIFMA Index	86.2% of 1-month LIBOR	50,000	50,000
Fixed-payer	2044	3.246%	65% of LIBOR + 0.12%	50,000	50,000
Fixed-payer	2044	3.497%	65% of LIBOR + 0.12%	50,000	50,000
Fixed-payer	2042	3.640%	70% of 1-month LIBOR	26,590	26,590
Basis	2032	SIFMA Index	85.3% of 3-month LIBOR	50,000	50,000
Fixed-payer	2029	3.606%	64.11% of 5-year LIBOR	25,915	27,365
Fixed-payer	2030	5.091%	64.09% of 5-year LIBOR	9,140	9,855
Fixed-payer	2030	3.623%	91.03% of 5-year LIBOR	8,625	9,070
Fixed-payer	2026	3.780%	70% of 1-month LIBOR	8,185	8,875
Fixed-payer	2022	3.680%	70% of 1-month LIBOR	3,520	4,025
Fixed-payer	2021	3.308%	70% of 1-month LIBOR	11,045	13,025
Fixed-payer	2047	1.405%	70% of 1-month LIBOR	25,000	----
Fixed-payer	2047	1.207%	70% of 1-month LIBOR	25,000	----
				$ 543,020	541,305

(In thousands of dollars)

In 2016, the System terminated a basis swap with a notational value of $42,500 and a maturity date of 2027 generating a gain of $980. The System also entered into two fixed-payer basis swaps each for $25,000 notational value with 2047 maturity dates. These swap transactions were executed to take advantage of favorable market conditions.

In 2015, the System terminated two basis swaps with 2027 maturity dates generating a gain of $1,300.

SIFMA is an index of high-grade, tax-exempt variable rate demand obligations. SIFMA ranged from 0.01% to 0.87% (average rate of 0.42%) for the year ended December 31, 2016 and 0.01% to 0.11% (average rate of 0.03%) for the year ended December 31, 2015.

The net fair value of interest rate swap agreements totaled $56,167 as of December 31, 2016. The net fair value for swap agreements in 2016 consisted of $5,031 recorded in other assets and $61,198 recorded in other liabilities within the 2016 consolidated balance sheet. The net fair value of interest rate swap agreements totaled $66,623 as of December 31, 2015. The net fair value for swap agreements in 2015 consisted of $3,719 recorded in other assets and $70,342 recorded in other liabilities within the 2015 consolidated balance sheet.

Change in fair value of derivative instruments in the consolidated statements of operations and changes in net assets totaled $10,456 and $(2,991) for the years ended December 31, 2016 and 2015, respectively. Cash paid to counterparties totaled $10,701 and $10,734 for the years ended December 31, 2016 and 2015, respectively. Cash received from counterparties totaled $2,592 and $3,153 for the years ended December 31, 2016 and 2015, respectively.

The System posted collateral of $5,875 and $6,516 due to the decrease in swap valuations as of December 31, 2016 and 2015, respectively. The collateral is comprised of U.S. Treasury and government securities, is limited as to use, and is recorded as an investment within the consolidated balance sheets.

(10) Operating Leases

The System leases various facilities and equipment under operating lease agreements, which extend to 2069. Lease expense in 2016 and 2015 totaled $40,952 and $38,203, respectively. Future minimum non-cancelable operating lease payments with terms in excess of one year are as follows:

2017	$	28,014
2018		20,339
2019		15,352
2020		10,609
2021		6,785
2022 and thereafter		24,204
	$	105,303

(11) Insurance

Western Reserve Assurance Company, Ltd. (Western Reserve), a wholly owned subsidiary of the System, provides professional and general liability insurance coverage on a claims-made basis for substantially all of the System. Effective July 1, 2004, Western Reserve was restructured from a single parent company to a segregated portfolio company (SPC), Western Reserve Assurance Company, Ltd., SPC (Western Reserve SPC). SPC is an insurance company that operates as a single legal entity, which allows for assets and liabilities to be segregated between different protected portfolios of the company. The individual segregated portfolios do not, by law, have access or rights to the assets of any of the other segregated portfolios within SPC. At December 31, 2016, the Western Reserve SPC consists of several individual segregated portfolios. Each segregated portfolio provides coverage for its respective entity's insurance programs and is consolidated into each respective entity's consolidated financial statements. Western Reserve SPC has reinsurance agreements with unrelated commercial carriers in place relative to a portion of the risks.

(In thousands of dollars)

Various claimants have asserted professional and general liability and workers' compensation claims against the System. These claims are in various stages of processing or are in litigation. In addition, there are known incidents, and there also may be unknown incidents, which may result in the assertion of additional claims. The System has accrued the actuarial estimate of both asserted and unasserted losses primarily based on actuarially determined amounts. The System's reserves for professional, general, and workers' compensation liabilities (including incurred but not reported claims) total $168,063 and $164,215 at December 31, 2016 and 2015, respectively. The current portion of the reserves, amounts to $10,000 in both years, is recorded in other current liabilities and the remaining portion is recorded in other long-term liabilities. The retention limits per occurrence for the various policies written by Western Reserve SPC range from $500 to $10,000.

(12) Pension Plans

The System maintains a noncontributory defined benefit pension plan (the plan) for the benefit of eligible employees. The benefits are based upon years of service and the employees' compensation, as defined by the plan. It is the System's policy to contribute annually to the defined benefit plan amounts that are actuarially determined to provide the plan with sufficient assets to meet future benefit payment requirements. In April 2015, the System froze its final average pay formula benefit, replacing it with a cash balance formula.

The System recognizes the funded status (difference between the fair value of plan assets and the projected benefit obligation) of the defined benefit pension plan on its consolidated balance sheets. Gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit costs are recognized as a component of unrestricted net assets. The System uses December 31 as the measurement date for plan assets and benefit obligations.

The amounts recognized in changes in unrestricted net assets at December 31, 2016 and 2015 consisted of the following:

		2016	2015
Amount recognized in unrestricted net assets at end of year:			
Unrecognized actuarial loss	$	496,460	467,860
Unrecognized prior service costs		(15,686)	(18,079)
Net amount recognized	$	480,774	449,781

(In thousands of dollars)

The accumulated benefit obligation for the plan was $1,088,339 and $1,032,246 as of December 31, 2016 and 2015, respectively. The following represents selected information about the plan as of December 31, 2016 and 2015:

		2016	2015
Change in benefit obligation:			
Projected benefit obligation (PBO) at beginning of year	$	1,051,227	1,074,773
Service cost		41,292	42,977
Interest cost		38,090	43,689
Actuarial (gain) loss		51,982	(36,570)
Benefits paid		(71,827)	(53,158)
Plan amendment		—	(20,484)
Projected benefit obligation at end of year		1,110,764	1,051,227
Change in plan assets:			
Fair value of assets at beginning of year		722,570	776,158
Actual return on assets		38,565	(1,260)
Employer contribution		21,800	830
Benefits paid		(71,827)	(53,158)
Fair value of assets at end of year		711,108	722,570
Funded status (PBO in excess of plan assets)	$	(399,656)	(328,657)

		2016	2015
The components of periodic pension costs included the following:			
Service cost	$	41,292	42,977
Interest cost		38,090	43,689
Expected return on plan assets		(51,256)	(56,081)
Amortization of prior service costs		(2,393)	(2,393)
Recognized net actuarial loss		36,073	42,547
Net periodic pension cost	$	61,806	70,739

(Continued)

(In thousands of dollars)

The amounts in unrestricted net assets expected to be recognized as components of net periodic pension costs in 2017 are as follows:

Amortization of prior service costs	$	(2,398)
Recognized actuarial losses		39,656
Total	$	37,258

The weighted average assumptions used to determine benefit obligations and net benefit cost for the years ended December 31, 2016 and 2015 were as follows:

	2016	**2015**
Weighted average assumptions:		
Discount rate	4.29%	4.58%
Expected return on plan assets	6.75	6.75
Rate of compensation increase (*)	3.75	3.00/3.75

(*) 3.00% in 2016 and age-graded scale thereafter

Pension assets are invested in various asset classes as follows:

	2016	**2015**
Asset class:		
Equities, mutual and exchange traded funds	44%	39%
Fixed income	22	24
Alternative investments	32	31
Cash and cash equivalents	2	5

The Investment Committee of the Board of Directors has responsibility for establishing and monitoring compliance with the investment policy governing the investment of pension assets. The investment policy is utilized as the basis for determining the long-term return assumption for the assets. Historical data, combined with future expected returns of each asset class, are the primary components utilized in developing this assumption. Additional information, such as specific manager performance and risk characteristics, is also included in the assessment of the long-term rate of return assumption.

The System expects to contribute $115,000 to the plan in 2017. The estimated benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the System as follows: 2017 – $67,493; 2018 – $73,405; 2019 – $76,855; 2020 – $80,633; 2021 – $83,682; and 2022 to 2026 – $447,543.

(Continued)

(In thousands of dollars)

The following tables present the System's fair value leveling hierarchy for those plan assets measured at fair value as of December 31, 2016 and 2015. Refer to note 5 for level definitions.

	Level 1	Level 2	Level 3	Total
December 31, 2016:				
Cash and cash equivalents	$ 14,104	—	—	14,104
Fixed income securities:				
Corporate bonds	84,049	—	—	84,049
Government securities	24,762		—	24,762
Total fixed income securities	108,811	—	—	108,811
Equities, mutual and exchange traded funds:				
Domestic mutual and commingled funds	81,915	—	—	81,915
International mutual and commingled funds	110,369	—	—	110,369
Total equities, mutual and exchange traded funds	192,284	—	—	192,284
Total	$ 315,199	—	—	315,199

	Level 1	Level 2	Level 3	Total
December 31, 2015:				
Cash and cash equivalents	$ 38,918	—	—	38,918
Fixed income securities:				
Corporate bonds	172,184	—	—	172,184
Government securities	—	34	—	34
Total fixed income securities	172,184	34	—	172,218
Equities, mutual and exchange traded funds:				
Domestic mutual and commingled funds	80,420	—	—	80,420
International mutual and commingled funds	101,951	—	—	101,951
Total equities, mutual and exchange traded funds	182,371	—	—	182,371
Total	$ 393,473	34	—	393,507

(In thousands of dollars)

The plan held certain investments in cash and cash equivalents consisting of short-term money market instruments including commercial paper, asset backed securities, treasury bonds and bills, and short-term corporate bonds. The plan also holds certain alternative investments including hedge funds, real estate, and distressed debt.

The following table summarizes the System's investments at December 31, 2016 and 2015, for which NAV was used as a practical expedient to estimate fair value:

	2016	2015
Fixed income securities:		
Corporate bonds	$ 46,021	—
Equities, mutual and exchange traded funds:		
Domestic mutual and commingled funds	16,514	13,818
International mutual and commingled funds	104,977	89,020
Total equities, mutual and exchange traded funds	121,491	102,838
Alternative investments:		
Hedge funds	104,315	13,732
Real estate	67,667	62,312
Distressed debt	31,468	28,120
Private eqiuity	24,947	22,061
Total alternative investments	228,397	126,225
Total	$ 395,909	229,063

The table below classifies the net asset value at December 31, 2016 for the alternative investment portion of the plan assets into categories based on the stated contractual liquidity terms of the underlying investments:

	Net asset value	Unfunded commitments
Less than 1 year, no contractual restrictions have been imposed	$ 71,189	9,107
Subject to existing gates or restrictions	23,535	—
Limited partnership fund expiring in 1–5 years	23,356	750
Limited partnership fund expiring in 6–10 years	69,477	32,031
Limited partnership fund expiring in 11–15 years	40,840	36,207
Total alternative investments	$ 228,397	78,095

The System sponsors various defined contribution plans. The System contributed $28,961 and $22,080 to the defined contribution plans for the years ended December 31, 2016 and 2015, respectively.

The System also has nonqualified deferred compensation plans for certain employees. The System contributed and expensed $4,370 and $4,644 to the deferred compensation plans for the years ended December 31, 2016 and 2015, respectively.

(13) Investments in Joint Ventures

The System has invested in a number of joint ventures to provide specialty healthcare services which are recorded on the equity method of accounting. During 1997, the System entered into an agreement with Southwest Community Health System and certain of its affiliated entities, including Southwest General Health Center (Southwest). The agreement has been amended and restated as of January 1, 2011 and is effective for 10 years. The agreement provides that 50% of the voting members of Southwest's board of trustees shall be selected for appointment by the System and that the System is entitled to 50% of the annual net income as defined in the agreement. Earnings under the Southwest joint venture for the years ended December 31, 2016 and 2015 were $3,366 and $682, respectively. Total investment in Southwest amounted to $65,574 and $62,208 at December 31, 2016 and 2015, respectively. Total investments for all joint ventures, including Southwest, amounted to $79,441 and $73,944 at December 31, 2016 and 2015, respectively, and are included in noncurrent other assets on the consolidated balance sheets..

(14) Care Assurance

Various subsidiaries of the System participate in the State of Ohio's Care Assurance Program, which was established in 1988 to assist Ohio hospitals that had a disproportionate amount of uncompensated care. Under the program, Ohio hospitals, including the System's hospitals, are assessed an amount which forms a pool of funds to be matched with federal Medicaid funds for payments to hospitals. Total net revenues to the System under the Care Assurance Program totaled $17,844 and $16,383 in 2016 and 2015, respectively. The System records the net proceeds in net patient service revenue.

(15) Litigation and Contingencies

The System is involved in litigation arising in the ordinary course of business. Claims have been asserted against the System and are currently in various stages of litigation. It is the opinion of management that estimated costs accrued are adequate to provide for potential losses resulting from pending or threatened litigation.

(16) Special Charges

The System incurred $3,764 and $4,293 in special charges during 2016 and 2015, respectively. The special charges related primarily to severance, impairments, and restructuring costs.

(17) Purchase Commitments

The System has commitments to purchase goods and services with the following minimum contractual obligations as follows: 2017 – $35,877; 2018 – $35,679; 2019 – $31,057; 2020 – $27,637; and 2021 – $7,143; and 2022 and thereafter – $10,341. Purchases under these contracts totaled $152,583 and $197,671 in 2016 and 2015, respectively, and met the provisions of the agreement. In 2001, the System entered into a thirty-year agreement with a utilities company, a related party, which provides utilities to

(Continued)

(In thousands of dollars)

certain buildings at UHCMC. The amounts purchased were $21,077 and $22,971 in 2016 and 2015, respectively.

(18) Income Taxes

The System has certain taxable subsidiaries that have incurred net losses for federal income tax purposes. The System acquired three hospitals and their respective entities in 2015 that increased these net losses. Cumulative losses available totaled approximately $632,318 and $525,317 at December 31, 2016 and 2015, respectively. The losses are available to offset future taxable income and expire in varying amounts through the year 2036. A potential tax benefit has not been recorded in the consolidated financial statements at December 31, 2016 and 2015 due to the uncertainty of realizing those benefits in the future.

The System must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. As of December 31, 2016 and 2015, the System does not have any uncertain tax positions.

(19) Functional Expenses

The System provides healthcare services, medical education, and performs medical research. Expenses related to these functions were as follows:

		2016	2015
Healthcare services	$	2,866,773	2,402,322
Medical education		158,672	149,735
Medical research		115,599	112,151
General and administrative		540,442	524,878
Special charges		3,764	4,293
Total expenses	$	3,685,250	3,193,379

(20) Related Parties

Certain members of the System's Board of Directors serve as management of companies that provide products and/or services to the System or with which the System has a contract or other relationship (e.g., schools). Two members of the System's Board of Directors are employees: the Chief Executive Officer and a physician employed by one of the entities in the System. The System's management believes that transactions with related parties are entered into upon terms comparable to those that would be available from unaffiliated third parties. Related party transactions are reviewed by the Audit & Compliance Committee.

(21) Member Substitutions

In 2015, identifiable assets and liabilities were assumed by the System as a result of either a member substitution or member withdrawal agreement with Portage, St. John and Samaritan and were recorded at fair value.

(In thousands of dollars)

Portage consists of the parent corporation and multiple subsidiaries. Portage is a 117-staffed-bed progressive hospital serving the residents of Portage County. Portage includes an urgent care facility; comprehensive imaging facilities; a network of physician practices; and outpatient centers and medical facilities throughout Portage County.

St. John Medical Center is a 204-bed, full-service, not-for-profit, acute care hospital providing comprehensive healthcare to residents of western Cuyahoga and eastern Lorain counties, which owns Westshore Primary Associates Inc., a for-profit physician practice network of more than 50 physicians who range in specialties from family practice to obstetrics. Prior to merger, the System and SCHS each had a 50% membership in St. John. The System paid SCHS $45,200 for their 50% ownership as shown below.

Samaritan is an acute care hospital with 49 acute-care beds located in Ashland, Ohio and also operates four medical office buildings, an outpatient clinic, an offsite rehab facility, and an administrative office building. Other legal entities include Samaritan Professional Corporation and the Samaritan Hospital Foundation, which was formed in October 1994 for the purpose of performing charitable functions on behalf of Samaritan.

The following table summarizes the fair values identified as December 31, 2015:

	Fair value
Cash	$ 41,863
Other current assets	64,076
Investments	30,002
Property, plant and equipment, net	179,279
Long-term assets	72,792
Total assets	388,012
Current liabilities	58,412
Long-term debt	72,025
Other liabilities	12,472
Total liabilities	142,909
Net assets	245,103
Dissolution of Joint Venture	(34,168)
Cash paid	(45,200)
Adjusted net assets	$ 165,735
Allocation of member substitutions:	
Unrestricted net assets	100,883
Temporarily restricted net assets	$ 59,461
Permanently restricted net assets	5,391
	$ 165,735

(In thousands of dollars)

The following unaudited pro forma financial information presents the combined historical results of operations of the System, Portage, Samaritan, and St. John as if the member changes had occurred on the first day of 2015. The unaudited pro forma financial information includes certain adjustments related to the acquisition, such as the reduction in depreciation expense from the fair value of property, plant and equipment.

Unaudited pro forma consolidated results of operations as of December 31, 2015 are as follows:

	Year ended December 31, 2015
Pro forma revenues	$ 3,559,954
Pro forma excess revenues over expenses	138,605

The unaudited pro forma financial information is not intended to represent or be indicative of what would have occurred if the transactions had taken place on the dates presented and is not indicative of what the System's actual results of operations would have been had the member substitutions been completed at the beginning of the periods indicated above. Further, the pro forma combined results do not reflect one-time costs to fully merge and operate the combined organization more efficiently, or anticipated synergies expected to result from the member substitutions and should not be relied upon as being indicative of future results that the System will experience.

(22) Subsequent Events

Management has evaluated subsequent events through March 22, 2017, which represents the date the consolidated financial statements were available for issuance, to ensure that the consolidated financial statements include appropriate disclosures of events both recognized in the consolidated financial statements as of December 31, 2016, and events which occurred subsequent to December 31, 2016, but were not recognized in the consolidated financial statements.