PRESBYTERIAN

Presbyterian Healthcare Services
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www.phs.org

April 27, 2017

Digital Assurance Certification
315 East Robinson Street
Suite 300
Orlando, Florida 32801

ATT'N: Shana Blanchard

RE: 1. Continuing Disclosure Agreement(s) dated as of November 25, 2008 between Presbyterian Healthcare Services and Wells Fargo Bank, National Association (the "Continuing Disclosure Agreement")

2. Continuing Disclosure Agreement dated as of September 24, 2009 between Presbyterian Healthcare Services and Wells Fargo Bank, National Association (the "Continuing Disclosure Agreement")

3. Continuing Disclosure Agreement dated as of August 30, 2012 between Presbyterian Healthcare Services and Wells Fargo Bank, National Association (the "Continuing Disclosure Agreement")

4. Continuing Disclosure Agreement dated as of May 19, 2015 between Presbyterian Healthcare Services and Wells Fargo Bank, National Association (the "Continuing Disclosure Agreement")

Dear Ms. Blanchard,

Pursuant to Section 3(c) of all of the above referenced Continuing Disclosure Agreements and in my capacity as an Obligate Group Representative, I hereby certify that the enclosed Annual Financial Information and Annual Operating Information as of December 31, 2016 for the Obligated Group, as defined in the above referenced Continuing Disclosure Agreements complies with the applicable requirements of Section 3(c).

As per Section 3.10 of the above referenced Master Trust Indenture attached please find the Officer's Certificate stating compliance with the covenants contained in Article III of the Master Trust Indenture and disclosure of the Debt Service Coverage Ratio.

Please distribute copies of the audited financial statements (Annual Financial Information), Annual Operating Information, Officers Certificate pursuant to Section 3.10 of the Master Trust Indenture and discussion of operating results to the Master Trustee, each NRMSIR, SID (as applicable) and to the Electronic Municipal Market Access system for the Municipal Securities Rulemaking Board, each as defined in the Continuing Disclosure Agreements.

Should you have any questions, please do not hesitate to contact me at dmaxwell@phs.org or 505.923.5353.

Regards,

Dale Maxwell

Dale Maxwell
President & Chief Executive Officer

Enclosures

OFFICER'S CERTIFICATE
PURSUANT TO
Section 3.10 of the Master Trust Indenture (Amended and Restated)
Dated as of July 28, 2005
among
Presbyterian Healthcare Services, Presbyterian Healthcare Foundation, Bernalillo County Health Care Corporation and Other Members of the Obligated Group, if any
and
Wells Fargo Bank, National Association, as Trustee
(the "Master Indenture")

I, the undersigned, hereby certify that I am the duly chosen, qualified and acting President and Chief Executive Officer of Presbyterian Healthcare Services and that:

1. To the best knowledge of the undersigned, all Members of the Obligated Group have complied with the covenants contained in Article III of the Master Trust Indenture (Amended and Restated) dated as of July 28, 2005 among Presbyterian Healthcare Services, Presbyterian Healthcare Foundation, and Bernalillo County Healthcare Corporation and Wells Fargo Bank New Mexico, N.A., as Trustee.

2. The Debt Service Coverage Ratio of the Obligated Group for the period ending December 31, 2016 was 5.06.

3. The terms used in this Officer's Certificate shall have the meaning specified in the Master Indenture.

PRESBYTERIAN HEALTHCARE SERVICES

Date: April 27, 2017

By: Dale Maxwell
Dale Maxwell
President and Chief Executive Officer

Combined Financial Statements and Supplementary Information

Presbyterian Healthcare Services and Affiliates
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Presbyterian Healthcare Services and Affiliates

Combined Financial Statements
and Supplementary Information

Years Ended December 31, 2016 and 2015

Contents

Building a better working world

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Report of Independent Auditors

The Board of Directors
Presbyterian Healthcare Services

We have audited the accompanying combined financial statements of Presbyterian Healthcare Services and Affiliates, which comprise the combined balance sheets as of December 31, 2016 and 2015, and the related combined statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Presbyterian Healthcare Services and Affiliates at December 31, 2016 and 2015, and the combined results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

April 21, 2017

Presbyterian Healthcare Services and Affiliates

Combined Balance Sheets

	December 31 2016	2015
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 302,030**	$ 285,896
Accounts receivable, less allowance for doubtful accounts of $33,378 and $33,702 in 2016 and 2015, respectively	**120,201**	113,367
Other receivables	**121,034**	119,958
Estimated third-party payor receivable	**4,024**	–
Inventories, prepaid expenses, and other current assets	**47,962**	49,468
Total current assets	**595,251**	568,689
Assets limited as to use or restricted:		
Designated for long-term purposes	**1,835,466**	1,688,322
Designated for self-insurance funds	**127,749**	119,338
Restricted by donors	**38,274**	34,807
Held by trustee	**23,757**	51,838
Restricted for statutory requirements	**116,962**	109,716
	2,142,208	2,004,021
Property and equipment, net	**850,763**	857,048
Goodwill	**55,626**	55,626
Other assets	**87,447**	78,836
Total assets	**$ 3,731,295**	$ 3,564,220
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 59,930**	$ 57,782
Due under Medicaid contract	**186,390**	168,296
Accrued liabilities	**179,914**	161,570
Medical claims payable	**136,442**	139,397
Estimated third-party payor settlements	**–**	1,826
Current portion of long-term debt and capital leases	**14,677**	14,797
Total current liabilities	**577,353**	543,668
Long-term debt and capital leases, net of current portion	**684,707**	703,535
Employee benefit plans	**206,041**	198,511
Self-insurance plans	**122,787**	145,092
Other liabilities	**101,675**	107,032
Total liabilities	**1,692,563**	1,697,838
Net assets:		
Unrestricted	**1,999,386**	1,829,534
Temporarily restricted	**28,126**	25,997
Permanently restricted	**11,220**	10,851
Total net assets	**2,038,732**	1,866,382
Total liabilities and net assets	**$ 3,731,295**	$ 3,564,220

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Operations

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Revenues:		
Net premiums	**$ 2,047,220**	$ 1,819,856
Patient service revenue	**1,073,754**	1,059,443
Less provision for doubtful accounts	**(53,051)**	(56,481)
Net patient service revenue	**1,020,703**	1,002,962
Other operating revenues	**68,205**	72,437
Total operating revenues	**3,136,128**	2,895,255
Expenses:		
Medical claims	**1,218,620**	1,044,092
Salaries, wages and employee benefits	**917,048**	873,637
Purchased services and other	**477,336**	453,876
Supplies	**281,210**	240,788
Professional fees	**43,096**	38,049
Depreciation and amortization	**95,933**	94,612
Interest	**27,971**	24,886
Total expenses	**3,061,214**	2,769,940
Operating income	**74,914**	125,315
Other income (loss):		
Investment income	**74,135**	71,593
Net unrealized gains (loss) on investments	**53,087**	(106,125)
Loss on bond defeasance	**–**	(24,061)
Pension settlement	**(24,176)**	–
Change in fair value of interest rate swaps	**4,186**	(149)
Total other income (loss)	**107,232**	(58,742)
Excess of revenues over expenses before income taxes	**182,146**	66,573
Provision for income taxes	**24,794**	35,086
Excess of revenues over expenses	**$ 157,352**	$ 31,487

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Changes in Net Assets

	Year Ended December 31 2016	2015
	(In Thousands)	
Unrestricted net assets		
Excess of revenues over expenses	**$ 157,352**	$ 31,487
Change in pension obligation	**13,188**	(2,015)
Other changes in net assets	**(688)**	361
Increase in unrestricted net assets	**169,852**	29,833
Temporarily restricted net assets		
Donor-restricted contributions and earnings	**3,193**	2,951
Net assets released from restrictions	**(1,861)**	(2,466)
Net unrealized gains on investments	**704**	(1,687)
Other changes in net assets	**93**	56
Increase (decrease) in temporarily restricted net assets	**2,129**	(1,146)
Permanently restricted net assets		
Other changes in net assets	**369**	2,485
Increase in permanently restricted net assets	**369**	2,485
Increase in net assets	**172,350**	31,172
Net assets, beginning of year	**1,866,382**	1,835,210
Net assets, end of year	**$ 2,038,732**	$ 1,866,382

See accompanying notes.

Presbyterian Healthcare Services and Affiliates

Combined Statements of Cash Flows

	Year Ended December 31 2016	2015
	(In Thousands)	
Operating activities		
Increase in net assets	**$ 172,350**	$ 31,172
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Unrealized gains (loss) on investments	**(53,087)**	106,125
Change in fair value of interest rate swaps	**(4,186)**	149
Loss on bond defeasance	**–**	24,061
Loss on pension settlement	**24,176**	–
Depreciation and amortization	**95,933**	94,612
Provision for doubtful accounts	**53,051**	56,481
Changes in operating assets and liabilities:		
Accounts receivable	**(59,885)**	(59,112)
Other receivables	**(1,076)**	(28,430)
Estimated third-party payor receivable/settlements	**(5,850)**	(1,140)
Inventories, prepaid expenses, and other current assets	**1,506**	(12,563)
Trading securities, net	**(105,935)**	(225,470)
Other assets	**(8,611)**	(5,882)
Accounts payable	**2,148**	2,433
Due under Medicaid contract	**18,094**	122,705
Accrued liabilities	**18,344**	1,501
Medical claims payable	**(2,955)**	11,478
Other liabilities	**(40,122)**	16,046
Net cash provided by operating activities	**103,895**	134,166
Investing activities		
Sales of assets held by trustee and statutory deposits	**42,916**	90,453
Purchases of assets held by trustee and statutory deposits	**(22,081)**	(141,078)
Purchases of property and equipment	**(89,648)**	(133,924)
Net cash used in investing activities	**(68,813)**	(184,549)
Financing activities		
Proceeds from issuance of long-term debt	**–**	262,140
Payments on long-term debt and capital leases	**(18,948)**	(171,188)
Net cash (used in) provided by financing activities	**(18,948)**	90,952
Net increase in cash and cash equivalents	**16,134**	40,569
Cash and cash equivalents, beginning of year	**285,896**	245,327
Cash and cash equivalents, end of year	**$ 302,030**	$ 285,896
Supplemental disclosures of cash flow information		
Cash paid for interest	**$ 29,406**	$ 26,662
Cash paid for income taxes	**$ 14,435**	$ 51,130

See accompanying notes.

1. Organization

Presbyterian Healthcare Services (PHS) is a New Mexico nonprofit corporation exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code). PHS is a diversified health care organization that owns, leases, controls, operates, or manages a variety of health care-related organizations, including six hospitals in New Mexico, a for-profit managed care organization (MCO), and several other affiliated organizations. PHS provides a broad range of health care services, including inpatient, outpatient, subacute, home health care and physician services.

PHS consists of the following divisions and affiliates:

Presbyterian Healthcare Services Divisions	Presbyterian Healthcare Services Affiliates
Presbyterian Hospital,* including the following, which are designated as remote locations of Presbyterian Hospital:	Southwest Health Foundation
Presbyterian Kaseman Hospital*	Presbyterian Network, Inc. (PNI):
Presbyterian Northside*	Presbyterian Insurance Company, Inc. (PIC)
Presbyterian Rust Medical Center*	Presbyterian Health Plan, Inc. (PHP)
Plains Regional Medical Center*	Albuquerque Imaging Associates
Presbyterian Española Hospital*	Southwest Magnetic Imaging Associates
Socorro General Hospital*	Presbyterian Properties, Inc.
Lincoln County Medical Center (leased facility)	Presbyterian Healthcare Foundation*
Dr. Dan C. Trigg Memorial Hospital (leased facility)	Bernalillo County Health Care Corporation d.b.a. Albuquerque Ambulance Service*

*Denotes Obligated Group members.

PHS accesses the capital markets through an Obligated Group. Obligated Group members include PHS and certain divisions and affiliates as noted above, which are jointly and severally liable for the long-term debt outstanding under a Master Trust Indenture. None of the other PHS affiliates have any obligation related to requirements of the Master Trust Indenture. The Obligated Group's net assets represent approximately 76% and 75% of PHS and affiliates' combined net assets at December 31, 2016 and 2015, respectively.

1. Organization (continued)

Presbyterian Network, Inc. (PNI) is a wholly owned subsidiary of Southwest Health Foundation. PNI is the parent organization of two wholly owned subsidiaries: Presbyterian Health Plan, Inc. (PHP) and Presbyterian Insurance Company, Inc. (PIC). PHP is a state-licensed Health Maintenance Organization (HMO) in New Mexico and is also a federally qualified HMO under Title XIII of the Public Health Service Act. PHP provides comprehensive health care services in New Mexico to individuals primarily through health maintenance contracts with employer groups and individuals, both on and off the New Mexico Health Insurance Exchange. At the end of 2013, the State of New Mexico's Salud! Medicaid Contract expired and was replaced with the Centennial Care program beginning January 1, 2014. The Company has a five-year contract with the State of New Mexico to provide physical health, behavioral health, and long-term care services to Medicaid eligible individuals under the Centennial Care program. PHP also offers an HMO product to Medicare-eligible individuals (Medicare Advantage). The Medicare Advantage product provides managed care services that include all Medicare benefits and, in some cases, additional managed care services. PIC offers preferred provider and indemnity products to individuals through contracts with employer groups.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying combined financial statements include the accounts of PHS and its affiliates as described in Note 1 (collectively, Presbyterian Healthcare Services). All significant intercompany balances and transactions have been eliminated in combination.

Pending Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, together with subsequent amendments, updates and an extension of the effective date (collectively the New Revenue Standard), which supersedes most existing revenue recognition guidance, including industry-specific health care guidance. The New Revenue Standard provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer

2. Summary of Significant Accounting Policies (continued)

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

This five-step process will require significant management judgment in addition to changing the way many companies recognize revenue in their financial statements. Additionally, and among other provisions, the New Revenue Standard requires expanded quantitative and qualitative disclosures, including disclosure about the nature, amount, timing and uncertainty of revenue. The provisions of the New Revenue Standard are effective for annual periods beginning after December 15, 2017, including interim periods within those years, by applying either the full retrospective method or the cumulative catch-up transition method. The full retrospective method requires application of the provisions of the New Revenue Standard for all periods presented while the cumulative catch-up transition method requires the application of the provisions of the New Revenue Standard as of the date of adoption with the cumulative effect of the retrospective application of the provisions as an adjustment through net assets. Currently, PHS anticipates adopting the provisions of the New Revenue Standard using the full retrospective method for all periods presented. Early adoption is permitted starting with annual periods beginning after December 31, 2016. PHS does not plan to early adopt.

As PHS progresses with its implementation efforts to adopt the New Revenue Standard, management continues to evaluate and refine its estimates of the anticipated impacts it will have on its revenue recognition policies, procedures, financial position, results of operations, cash flows, financial disclosures and control framework. Specifically, PHS is continuing to evaluate its population of revenue sources to determine an appropriate level of stratification, as well as assess all of the potential effects the New Revenue Standard will have on variable consideration arising from settlements with third-party payors, disproportionate share hospital payments and bundled payments. However, PHS does anticipate that, as a result of certain changes required by the New Revenue Standard, the majority of its provision for doubtful accounts will be recognized as a direct reduction to revenues, instead of separately as a deduction to arrive at revenue.

2. Summary of Significant Accounting Policies (continued)

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820)*: *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).* Topic 820, *Fair Value Measurement*, permits a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment. ASU 2015-07 removes the requirement to categorize investments within the fair value hierarchy for which fair values are measured using the net asset value per share practical expedient. It also limits disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. This accordance standard is effective for fiscal years beginning after December 15, 2016. Management has evaluated the impact of adopting this standard, which will primarily impact the pension asset disclosures.

In May 2015, the FASB issued ASU 2015-09, *Insurance (Topic 944), Disclosures about Short-Duration Contracts*. ASU 2015-09 requires insurers to make additional disclosures about short-duration contracts (i.e., coverage provided for a fixed period of short duration, typically a year or less) for products such as health insurance. The disclosures focus on the liability for unpaid claims and claim adjustment expenses. Among other things, insurers will have to provide tables showing incurred and paid claims development information by claim year for the number of years claims typically remain outstanding (but not more than 10 years). Insurers also will have to provide a reconciliation of this information to the statement of financial position. ASU 2015-09 is effective for annual reporting periods beginning after December 15, 2016. PHS is evaluating the impact that the adoption of this standard will have on its disclosures.

In February 2016, the FASB issued ASU 2016-02*, Leases (Topic 842)*. ASU 2016-02 requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018. PHS anticipates that the adoption of ASU 2016-02 will result in an increase in both total assets and total liabilities. PHS is evaluating the impact that the adoption of this standard will have on its policies and procedures.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This accounting standard will change the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard will also allow companies to elect to use either the direct or indirect cash flow method, and requires additional liquidity disclosures and presentation of expenses by both natural and functional classification. This accounting standard is

2. Summary of Significant Accounting Policies (continued)

effective for fiscal years beginning after December 15, 2017 and interim periods thereafter. Management will continue to monitor and evaluate the impact of the adoption on the financial statements and related disclosures.

Adopted Accounting Pronouncements

In April 2015, the FASB issued ASU No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, ASU 2015-03 requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in ASU 2015-03. PHS retrospectively adopted the accounting standard in 2016. The 2015 combined financial statements have been reclassed to conform to 2016 presentation and $6,437 of debt issuance costs at December 31, 2015 have been reclassified from other assets to long-term debt.

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits and highly liquid investments with original maturities at the time of purchase of three months or less. The carrying value of cash and cash equivalents approximates fair value.

Net Patient Accounts Receivable

Net patient accounts receivable have been adjusted to the estimated amounts expected to be collected. Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, PHS analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for doubtful accounts.

Management regularly reviews data about these major payor 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, PHS analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for doubtful accounts, if necessary (for example, for expected uncollectible deductibles and co-payments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties

2. Summary of Significant Accounting Policies (continued)

that make the realization of amounts due unlikely). PHS has a policy of providing discounts to self-pay patients without insurance. For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and co-payment balances due for which third-party coverage exists for part of the bill), PHS records a significant provision for doubtful accounts 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 applicable) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

PHS's allowance for doubtful accounts as a percentage of self-pay patient receivables was 78% and 77% at December 31, 2016 and 2015, respectively. PHS's provision for doubtful accounts decreased to $53,051 for fiscal year 2016 from $56,481 for fiscal year 2015. PHS's uninsured discount policies during fiscal years 2016 and 2015 provided for a discount of 30% from standard rates for most services. These uninsured discounts are recorded with contractual adjustments as a deduction of patient service revenue.

PHS does not maintain a material allowance for doubtful accounts for accounts receivable from third-party payors, nor have there been significant write-offs from third-party payors.

Assets Limited as to Use or Restricted

Assets limited as to use or restricted include assets set aside by PHS for future long-term purposes, including capital improvements and self-insurance over which PHS retains control and may at its discretion subsequently use for other purposes, and investments held by PNI that are used to meet specified capital requirements for regulatory purposes. In addition, assets limited as to use or restricted include assets held by trustees under bond indenture agreements, contributions by donors with stipulated restrictions, and amounts on deposit to satisfy statutory requirements of the New Mexico Office of Superintendent of Insurance.

2. Summary of Significant Accounting Policies (continued)

These assets consist primarily of cash, cash equivalents, government securities, other fixed-income securities, equity securities, and alternative investments. The carrying amounts of investments in marketable debt and equity securities are reported on the combined balance sheets at fair value. Alternative investments are reported at net asset value using the equity method of accounting, except for alternative investments held by Presbyterian Healthcare Foundation, which are reported at fair value, and alternative investments held as fund assets related to the defined benefit pension plan, which are also reported at fair value.

Income or loss related to the investment portfolio (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law.

Income or loss restricted by donor or by law is classified as a change in temporarily or permanently restricted net assets consistent with the applicable restrictions.

As a condition of its Medicaid Centennial Care contract with the State of New Mexico Human Services Department (HSD), PHP is required to maintain an account with 90% of the average of the past three months capitation payments made to PHP from HSD. As of December 31, 2016 and 2015, respectively, $98,718 and $92,084 was held in bonds in a restricted managed asset account to satisfy this requirement. HSD also requires a reserve of 1.5% of monthly premium payments to be held in a segregated account related to performance guarantees under PHP's Centennial Care contract. At December 31, 2016 and 2015, $17,689 and $16,768, respectively, was held in a depository cash account to satisfy these requirements.

Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, requires the categorization of financial assets and liabilities into a three-level hierarchy based on pricing inputs to the valuation technique. The fair value hierarchy gives the highest priority to the quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The various levels of the fair value hierarchy are described as follows:

Level 1 – Pricing is based on observable inputs, such as quoted prices in active markets.

2. Summary of Significant Accounting Policies (continued)

Level 2 **–** Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 **–** Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third-party appraisals, discounted cash flow models and fund manager estimates.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in ASC 820. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

(a) *Market Approach* **–** Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities

(b) *Cost Approach* – Amount that would be required to replace the service capacity of an asset (replacement cost)

(c) *Income Approach* **–** Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option pricing and excess earnings models)

When observable market data is available, it is required to be used in determining the fair value measurement. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level of input that is significant to the fair value measurement.

2. Summary of Significant Accounting Policies (continued)

The majority of PHS's marketable debt and equity securities are measured based on observable market prices. PHS's interest rate swaps and systematic hedge overlay strategy are measured using models based upon observable pricing inputs. Note 7 further describes the methods applied to determine fair value of PHS's financial assets and liabilities.

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value due to their liquidity and short-term natures.

Inventories

Inventories, consisting of drugs and supplies, are stated at the lower of cost (first-in, first-out method) or market.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. For property and equipment under capital lease, amortization is determined over the shorter period of the lease term or the estimated useful life of the property and equipment. Such amortization is included in depreciation and amortization expense. The following useful lives are being used by PHS:

Land improvements	2–25 years
Buildings and improvements	5–40 years
Equipment and capitalized software	3–20 years

Interest cost incurred on borrowed funds, net of interest earned on assets held by trustee during the period of construction of qualified capital projects, is capitalized as a component of the cost of acquiring those assets.

Goodwill

PHS follows the provisions of ASC 350, *Intangibles – Goodwill and Other*. Goodwill is not amortized, but rather is tested annually for impairment. Management assesses goodwill impairment using a quantitative method and determined there was no goodwill impairment for the year ended December 31, 2016, and goodwill impairment of $1,963 for the year ended December 31, 2015.

2. Summary of Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

PHS evaluates whether events and circumstances have occurred that indicate the remaining estimated useful lives of long-lived assets, other than goodwill, may not be recoverable. The assessment of possible impairment is based on the ability to recover the carrying amount of the asset based on undiscounted cash flows. Impairments are calculated as the total by which the carrying amount of the asset exceeds its estimated fair value. For the year ended December 31, 2016 and 2015, management determined that there was no impairment of its long-lived assets.

Investments in Unconsolidated Entities

Investments in unconsolidated entities are accounted for under the cost or equity method of accounting, as appropriate. PHS utilizes the equity method of accounting for its investment in entities over which it exercises significant influence. PHS's equity income or loss on these investments is recorded as other operating revenue.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received. The gifts are reported as temporarily restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and recognized as a component of other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in other operating revenue.

Premium Revenues, Medical Claims Payable, and Health Care Expenses

Premium revenues are recognized in the month in which members are entitled to health care services. Premiums collected in advance are recorded as unearned premiums and are included in accrued liabilities on the accompanying combined balance sheets. During 2016 and 2015, premium

2. Summary of Significant Accounting Policies (continued)

revenue from the Medicare Advantage product line represented approximately 19% and 21%, respectively, of total premium revenue. In addition, during 2016 and 2015, premium revenue from the Medicaid product line represented approximately 61% and 59%, respectively, of total premium revenue. Coordination of benefits and subrogation are recognized in the period such amounts are determined to be recoverable from other insurers.

In 2014, PHP contracted with the state of New Mexico to serve the Medicaid population under the New Mexico Centennial Care program. All Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of this program. PHP was one of four MCOs awarded five-year contracts by the state to administer the New Mexico Centennial Care program.

Under this contract, PHP receives a fixed premium from the state to provide comprehensive health care services for enrollees, including those enrollees receiving services from PHS. PHS facilities and physicians will be paid capitated or discounted fee-for-service rates from each of the MCOs. The medical claims costs of PHP on the combined statements of operations are net of intercompany eliminations for services rendered by PHS facilities totaling $744,256 and $672,092 for the years ended December 31, 2016 and 2015, respectively.

Under the Medicaid Centennial Care contract, PHP is permitted to retain 100% of the underwriting gain generated up to 3% annually. Underwriting gains above 3% are shared 50/50 between PHP and HSD. Additionally, for a Medicaid expansion product and Hepatitis C drugs, PHP is subject to risk corridor adjustments. PHP and HSD share in excess gains or losses generated under the contract based on a tiered structure. Liabilities for the underwriting gain limitation and risk corridor of $166,459 and $105,906, as of December 2016 and 2015, respectively, are recorded on the accompanying combined balance sheets in due under Medicaid contract.

Under the Medicaid Centennial Care contract, PHP is also subject to retroactive enrollment reconciliation. Under the contract, members whose effective date of Medicaid eligibility is determined prior to HSD’s notification date are considered retroactive enrollment. Under the contract, PHP may retain premiums equal to the medical expense and a percentage of total medical expense for administrative costs. Medical expense in excess is reimbursed by HSD. Premiums in excess of medical expense and the percentage for administrative costs are due back to HSD. A liability for the retroactive enrollment reconciliation of $19,931 and $62,390, as of December 2016 and December 2015, respectively, are recorded on the accompanying combined balance sheets in due under Medicaid contract.

2. Summary of Significant Accounting Policies (continued)

PHP and PIC serve as plan sponsors to offer Medicare Part D prescription drug insurance coverage under a contract with the Centers for Medicare and Medicaid Services (CMS). Premium revenue is recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. Premium revenues are subject to a comprehensive risk reconciliation under which CMS shares in a portion of direct surplus or deficit related to Medicare Part D premiums. In addition to premium revenues, PHP and PIC receive prepayments from CMS related to low income, cost sharing, and catastrophic reinsurance subsidies. PHP and PIC are fully reimbursed by CMS for costs incurred under these contract elements, and, accordingly, there is no insurance risk to either company. Amounts received for these subsidies are not reflected as premium revenue, but rather are accounted for as deposits with the related liability recorded on the combined balance sheets. Pharmacy benefit costs not related to low income, cost sharing, or catastrophic reinsurance subsidies and administrative costs under the contract are expensed as incurred.

The estimated cost of all health services rendered to members through December 31 but not yet paid as of that date, is included in medical claims payable. This claims expense estimate is developed using actuarial assumptions based on historical experience with respect to the timing of payments in relation to the dates of service. Subsequent changes to prior period estimates are reflected in the current period. Losses on contracts are recognized in the period when health care costs are expected to exceed premium revenue.

PHS has agreements with third-party payors that provide for payments at amounts different from established charges. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement and negotiated discounts from established charges.

Patient Service Revenue

Patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations. The differences between the estimated and actual adjustments are recorded as part of patient service revenue in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews and investigations.

2. Summary of Significant Accounting Policies (continued)

For uninsured patients who do not qualify for charity care, PHS recognizes revenue on the basis of discounted rates, as provided by its policy. On the basis of historical experience, a significant portion of PHS's uninsured patients will be unable or unwilling to pay for the services provided. Thus, PHS records a significant provision for doubtful accounts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for doubtful accounts) is recognized from these major payor sources as follows:

	Year Ended December 31	
	2016	**2015**
Patient service revenue (net of contractual allowances and discounts):		
Third-party payors	**$ 1,021,171**	$ 1,007,036
Self-pay	**52,583**	52,407
Total	**$ 1,073,754**	$ 1,059,443

Charity Care

As an integral part of its mission, PHS provides care to all patients, regardless of ability to pay for needed services. A patient is classified as a charity patient in accordance with standards established across PHS and its affiliates. Charity care represents services rendered for which no, or only partial, payment is expected and, as such, is not included in revenues on the combined statements of operations.

Excess of Revenues Over Expenses

The combined statements of operations include a measurement for excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, include contributions of long lived assets (including assets acquired using contributions that, by donor restrictions, were to be used for the purpose of acquiring such assets) and changes in the pension liability.

2. Summary of Significant Accounting Policies (continued)

Other Income and Losses

Activities that result in gains or losses and are unrelated to the primary mission of PHS are considered to be other income and losses. Accordingly, investment income, changes in unrealized gains and losses on investments, gains (losses) on debt extinguishment, gains (losses) on the settlement of pension obligations and unrealized changes in the fair value of interest rate swaps are reported as a component of other income (loss).

Taxes

PHS and all of its affiliates, except for PNI and its subsidiaries, have been determined to be tax-exempt corporations by the Internal Revenue Service and generally are not subject to federal taxes on income.

The taxable affiliates utilize the liability method in accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the currently enacted tax rates and laws. Valuation allowances are used to reduce deferred tax assets to their estimated net realizable values when management determines ultimate recovery is not probable.

PHP and PIC are required to pay premium taxes to the state based on a percentage of adjusted premiums received related to the Commercial and Medicaid product lines. As a result of paying premium taxes, PHP and PIC are exempt from paying state income taxes. PHP and PIC recorded net premium tax expense totaling $54,119 and $40,656 in 2016 and 2015, respectively. These amounts are included within purchased services and other expenses on the accompanying combined statements of operations.

ASC 740, *Income Taxes*, prescribes criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As of December 31, 2016 and 2015, there was no significant impact on the combined financial statements related to the tax positions taken. There were no significant tax positions taken by management that required accrual as of December 31, 2016 or 2015.

2. Summary of Significant Accounting Policies (continued)

Derivative and Hedging Instruments

In accordance with ASC 815, *Derivatives and Hedging*, derivatives are recognized as either assets or liabilities at fair value on the combined balance sheets, regardless of the purpose or intent for holding them. For those derivatives not designated as hedges under such standards, the changes in fair value are recognized in excess of revenue over expenses. For those derivatives previously designated as hedges under such standards, the effective portion of the changes in fair value previously recognized in unrestricted net assets is being amortized into the excess of revenues over expenses over the remaining lives of the derivative instruments.

Benefit Plans

PHS is the plan sponsor of a defined benefit pension plan (Plan I) and five other limited postretirement benefit plans. The funded status of Plan I is recognized on the combined balance sheets as the difference between the fair value of the investments and the actuarially determined pension obligation. Other required disclosures of ASC 715, *Compensation – Retirement Benefits*, include the accumulated benefit obligation and fair value of the plan's assets, assumptions used in the benefit obligation calculation, contributions, the asset allocation of the plan, and the expected benefits to be paid, which can be found in Note 11.

In addition to Plan I, PHS and PHP sponsor certain defined contribution plans. Contributions to these plans are expensed as earned by the employees.

Use of Estimates

The preparation of combined financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results could differ from those estimates.

Subsequent Events

In preparing the accompanying combined financial statements, PHS has evaluated subsequent events through April 21, 2017, the date on which the accompanying combined financial statements were issued.

3. Patient Service Revenue

A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic and other factors.

Medicaid – The State Medicaid program consists of two primary plans. The larger plan is the Centennial Care program. All Medicaid services, including physical health, behavioral health, and long-term care, are provided as part of the New Mexico Centennial Care program. The second plan is a traditional Medicaid plan. PHS facilities and physicians are paid for inpatient acute care services on prospectively determined rates per discharge. Payments for outpatient services are made on a discounted fee-for-service basis.

The Medicare cost reports for Presbyterian Hospital, Plains Regional Medical Center and Presbyterian Española Hospital have been audited through December 31, 2013. The Medicare cost report of Lincoln County Medical Center, Socorro General Hospital and Dr. Dan C. Trigg Memorial Hospital has been audited by CMS through December 31, 2014. The Medicaid cost report for Presbyterian Hospital has been audited through December 31, 2012. The Medicaid cost reports for Presbyterian Española Hospital, Dr. Dan C. Trigg Memorial Hospital, Socorro General Hospital, Lincoln Medical County Center and Plains Regional Medical Center have been audited through December 31, 2014. Management believes that estimated settlements accrued related to unaudited cost reports are adequate.

Estimates are continually monitored and reviewed, and as settlements are made or estimates adjusted, differences are reflected in current operations. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

Others – PHS has also entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations. The basis for payment to PHS under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

(Dollar Amounts in Thousands)

3. Patient Service Revenue (continued)

Amounts received from third-party payors in excess of expected reimbursement are reflected as estimated third-party payor settlements on the accompanying combined financial statements.

PHS's major payor utilization percentages, based upon gross patient service revenue are summarized as follows:

	Year Ended December 31	
	2016	**2015**
Medicare	**41%**	40%
Commercial	**27**	28
Medicaid	**26**	26
Self-pay	**2**	2
Other	**4**	4
	100%	100%

4. Other Operating Revenues

Other operating revenues consist of the following:

	Year Ended December 31	
	2016	**2015**
Health plan administrative fees	**$ 24,460**	$ 22,798
Contributions and other	**29,814**	35,482
Tax appropriation revenue	**13,931**	14,157
	$ 68,205	$ 72,437

4. Other Operating Revenues (continued)

Electronic Health Records Incentive Payments

Starting in 2013, the Medicare and Medicaid programs are providing an incentive payment to eligible hospitals and professionals if meaningful-use certified electronic health record (EHR) technology is adopted. The incentive payment is recognized when management is reasonably assured that PHS has complied with the conditions set forth by Medicare and Medicaid. Approximately $2,733 and $7,220 in incentive payments were recognized in other operating revenue for the years ended December 31, 2016 and 2015, respectively, relating to the Medicare and Medicaid incentive programs. PHS's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, EHR incentive payments are subject to retrospective adjustments upon final settlement of the applicable cost report from which payments were initially calculated.

5. Community Benefit

In support of its mission and philosophy, PHS voluntarily provides free care to patients who cannot afford health care due to inadequate resources and/or patients who are uninsured. Because PHS does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as patient service revenues. The estimated cost of this voluntary free care less the amount, if any, ultimately received was $27,887 and $22,974 in 2016 and 2015, respectively.

In addition, PHS provides services to other patients under certain government-reimbursed public aid programs, which pay providers amounts that are generally less than the cost of rendering the services provided to the patients. The estimated unreimbursed cost of this care was approximately $122,256 and $80,690 in 2016 and 2015, respectively. These unreimbursed costs and costs of voluntary free care do not include any governmental funds received for providing access to health care to all residents of the local community.

PHS uses information from its cost accounting system and certain cost-to-charge ratios, where applicable, to estimate the cost of financial assistance and other community benefits reported.

(Dollar Amounts in Thousands)

5. Community Benefit (continued)

PHS, in furtherance of its mission, also commits significant time and resources to endeavors and critical services that meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screenings and assessments; cancer and other support groups; hospice programs; free transportation, lodging, meals and medications for transient patients when needed; funding for homeless health care programs; significant ongoing and temporary donations of office space and telephone systems for nonprofit health care organizations, including the American Heart Association and the Meals on Wheels program; elementary school education on Healthy Choices; free flu vaccine clinics; participation in regular blood drives; and the provision of educational opportunities for students interested in pursuing medical-related or pastoral careers.

6. Assets Limited as to Use or Restricted

PHS has designated the accumulation of certain funds for future replacement of property and equipment, other capital improvements, debt retirement, self-insurance reserves, and other long-term purposes. Under the terms of the Master Trust Indenture for the outstanding bond issues, funds held by the trustee have been established and legally designated for debt service and qualifying capital expenditures. The following is a summary of assets limited as to use or restricted at fair value, except for certain alternative investments, which are recorded at net asset value using the equity method:

	December 31	
	2016	**2015**
Cash and cash equivalents	**$ 60,909**	$ 87,531
Fixed-income securities	**815,217**	698,039
Equity securities	**819,052**	732,615
Alternative investments	**264,176**	223,107
Government securities and other	**120,791**	202,734
Public master limited partnerships	**62,063**	59,995
	$ 2,142,208	$ 2,004,021

6. Assets Limited as to Use or Restricted (continued)

Fixed-Income and Government Securities – This investment class includes investments in various fixed-income instruments that include investment-grade and high-yield domestic and international bonds, mortgage pools and bonds issued by U.S. government agencies. This investment class also includes investments in common trust funds, mutual funds, exchange-traded funds and separately managed accounts that hold investments in fixed-income securities. The fixed-income investments are exposed to various kinds and levels of risk, including interest rate risk, credit risk, foreign exchange risk and liquidity risk.

Equity Securities – This investment class consists primarily of common equity securities of domestic and international companies. These securities trade through the major public domestic and international exchanges. This investment class also includes investments in common trust funds, mutual funds and exchange-traded funds that hold investments in equity securities. The equity securities investments are exposed to various risks, including market risk; individual security risk; foreign exchange risk; and, for common equity of companies with a small market capitalization, liquidity risk.

Alternative Investments – Funds in this class are invested with external investment managers who invest primarily in various alternative categories, including real estate, long- and short-equity positions, merger and event arbitrage, natural resources, distressed credit, managed futures, fixed-income arbitrage and foreign exchange. These investments are domestic and international in nature and have varying degrees of illiquidity. The risks associated with these investments are numerous and include liquidity risk, market risk, event risk, interest rate risk, foreign exchange risk and investment manager risk. In addition, the investment managers are not required to register with the Securities and Exchange Commission and are not subject to regulatory controls. As unregistered investment vehicles, these funds are not required to disclose the holdings in their portfolios to investors. Given the numerous risks involved, these funds have a greater likelihood of losing invested capital.

Public Master Limited Partnerships – This investment class consists of master limited partnerships that invest in various domestic infrastructure assets within the energy industry. The securities held within the limited partnership trade through the major public domestic exchanges and are exposed to various risks, including market risk, individual security risk, regulatory risk, interest rate risk and liquidity risk.

(Dollar Amounts in Thousands)

6. Assets Limited as to Use or Restricted (continued)

As of December 31, 2016 and 2015, PHS had a total of $264,176 and $223,107, respectively, invested in alternative investments representing various hedge funds that include limited liability companies and limited liability partnerships, as follows:

	December 31	
	2016	**2015**
Equity long/short	**$ 21,353**	$ 12,373
Event driven	**33,569**	26,703
Relative value	**24,200**	15,700
Tactical trading	**30,385**	19,032
Private equity	**5,329**	4,609
Real assets	**103,669**	99,992
Total cost basis	**218,505**	178,409
Unrealized gain, net	**45,671**	44,698
	$ 264,176	$ 223,107

Approximately 98% of these alternative investments represent investments with original lockup periods ranging from one month to five years. The remaining exposure represents investments with longer lockups and limited redemption rights. There were no material unfunded commitments at December 31, 2016.

Investment income on assets limited as to use or restricted (excluding restricted by donor) consists of the following:

	Year Ended December 31	
	2016	**2015**
Interest and dividend income	**$ 42,313**	$ 37,905
Net realized gains on marketable securities and equity hedges	**31,822**	33,688
Total realized income	**74,135**	71,593
Net unrealized gains (loss) on marketable securities	**52,114**	(108,629)
Net unrealized gains on alternative investments	**973**	2,504
	$ 127,222	$ (34,532)

6. Assets Limited as to Use or Restricted (continued)

PHS has a hedging strategy related to the equity securities in the investment portfolio using derivatives to provide protection against a downturn in the equity markets. During 2016 and 2015, PHS realized gains of $5,781 and $2,984, respectively, from the hedge positions, which is included in investment income on the combined statements of operations. The hedging program was discontinued in February 2016 and consequently there were no outstanding positions at December 31, 2016. At December 31 2015, the fair value of the outstanding hedge positions was an asset of $1,660 which has been included in accrued liabilities on the accompanying combined balance sheets and changes in net unrealized gains on investments in the combined statements of operations.

7. Fair Value Measurements

The following table presents the fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis and alternative investments that are carried at net asset value using the equity method as of December 31, 2016:

	Level 1	Level 2*	Level 3	Fair Value	Equity Method	Carrying Value at December 31, 2016	Valuation Technique**
				(In Thousands)			
Designated for long-term purposes							
Money market	$ 14,878	$ –	$ –	$ 14,878	$ –	$ 14,878	a
Government and agencies	57,556	–	–	57,556	–	57,556	a
Bond funds	274,545	168,639	–	443,184	–	443,184	a/c
Corporate and municipal bonds	–	275,098	–	275,098	–	275,098	a
Equity funds	422,284	325,985	–	748,269	–	748,269	a
Other public equities	56,313	–	–	56,313	–	56,313	a
Alternative investments	–	710	10,560	11,270	228,898	240,168	a/c
Total designated for long-term purposes	$ 825,576	$ 770,432	$ 10,560	$1,606,568	$ 228,898	$ 1,835,466	
Designated for self-insurance funds							
Money market	$ 2,637	$ –	$ –	$ 2,637	$ –	$ 2,637	a
Government and agencies	1,287	–	–	1,287	–	1,287	a
Bond funds	26,740	14,371	–	41,111	–	41,111	a/c
Corporate and municipal bonds	–	5,200	–	5,200	–	5,200	a
Equity funds	27,087	29,268	–	56,355	–	56,355	a
Other public equities	4,664	–	–	4,664	–	4,664	a
Alternative investments	–	2,035	–	2,035	14,460	16,495	a
Total designated for self-insurance funds	$ 62,415	$ 50,874	$ –	$ 113,289	$ 14,460	$ 127,749	
Restricted by donors							
Money market	$ 287	$ –	$ –	$ 287	$ –	$ 287	a
Government and agencies	1,110	–	–	1,110	–	1,110	a
Bond funds	5,294	3,252	–	8,546	–	8,546	a/c
Corporate and municipal bonds	–	5,304	–	5,304	–	5,304	a
Equity funds	8,142	6,286	–	14,428	–	14,428	a
Other public equities	1,086	–	–	1,086	–	1,086	a
Alternative investments	–	473	7,040	7,513	–	7,513	a
Total restricted by donors	$ 15,919	$ 15,315	$ 7,040	$ 38,274	$ –	$ 38,274	
Held by trustee							
Money market	$ 23,757	$ –	$ –	$ 23,757	$ –	$ 23,757	a
	$ 23,757	$ –	$ –	$ 23,757	$ –	$ 23,757	
Restricted for statutory requirements							
Money market	$ 19,350	$ –	$ –	$ 19,350	$ –	$ 19,350	a
Government and agencies	23,016	37,822	–	60,838	–	60,838	a
Corporate and municipal bonds	–	36,774	–	36,774	–	36,774	a
	$ 42,366	$ 74,596	$ –	$ 116,962	$ –	$ 116,962	

7. Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value at December 31, 2016	Valuation Technique**
				(In Thousands)			
Financial assets (liabilities)							
Interest rate swaps	$ –	$ (22,668)	$ –	$ (22,668)	$ –	$ (22,668)	a

* Approximately 66% of Level 2 assets consist of commingled funds in which the underlying assets are primarily marketable debt and equity securities that trade on nationally recognized exchanges.

** Valuation techniques are described in Note 2.

The following table presents the fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2015:

	Level 1	Level 2*	Level 3	Fair Value	Equity Method	Carrying Value at December 31, 2015	Valuation Technique**
				(In Thousands)			
Designated for long-term purposes							
Money market	$ 14,116	$ –	$ –	$ 14,116	$ –	$ 14,116	a
Government and agencies	139,981	–	–	139,981	–	139,981	a
Bond funds	220,857	164,813	–	385,670	–	385,670	a/c
Corporate and municipal bonds	–	217,034	–	217,034	–	217,034	a
Equity funds	372,448	288,014	–	660,462	–	660,462	a
Other public equities	54,912	–	–	54,912	–	54,912	a
Alternative investments	–	643	9,798	10,441	205,706	216,147	a/c
Total designated for long-term purposes	$ 802,314	$ 670,504	$ 9,798	$1,482,616	$ 205,706	$ 1,688,322	
Designated for self-insurance funds							
Money market	$ 3,177	$ –	$ –	$ 3,177	$ –	$ 3,177	a
Government and agencies	1,866	–	–	1,866	–	1,866	a
Bond funds	25,991	9,402	–	35,393	–	35,393	a/c
Corporate and municipal bonds	–	15,198	–	15,198	–	15,198	a
Equity funds	28,695	30,965	–	59,660	–	59,660	a
Other public equities	4,044	–	–	4,044	–	4,044	a
Total designated for self-insurance funds	$ 63,773	$ 55,565	$ –	$ 119,338	$ –	$ 119,338	
Restricted by donors							
Money market	$ 267	$ –	$ –	$ 267	$ –	$ 267	a
Government and agencies	2,648	–	–	2,648	–	2,648	a
Bond funds	4,178	3,117	–	7,295	–	7,295	a/c
Corporate and municipal bonds	–	4,105	–	4,105	–	4,105	a
Equity funds	7,045	5,448	–	12,493	–	12,493	a
Other public equities	1,039	–	–	1,039	–	1,039	a
Alternative investments	–	428	6,532	6,960	–	6,960	a
Total restricted by donors	$ 15,177	$ 13,098	$ 6,532	$ 34,807	$ –	$ 34,807	

7. Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value at December 31, 2015	Valuation Technique**
			(In Thousands)				
Held by trustee							
Money market	$ 51,838	$ –	$ –	$ 51,838	$ –	$ 51,838	a
	$ 51,838	$ –	$ –	$ 51,838	$ –	$ 51,838	
Restricted for statutory requirements	*(revised)*	*(revised)*					
Money market	$ 18,133	$ –	$ –	$ 18,133	$ –	$ 18,133	a
Government and agencies	24,136	34,103	–	58,239	–	58,239	a
Corporate and municipal bonds	–	33,344	–	33,344	–	33,344	a
	$ 42,269	$ 67,447	$ –	$ 109,716	$ –	$ 109,716	
Financial assets (liabilities)							
Interest rate swaps	$ –	$ (26,790)	$ –	$ (26,790)	$ –	$ (26,790)	a
Equity hedges	$ –	$ 1,643	$ –	$ 1,643	$ –	$ 1,643	a

* Approximately 67% of Level 2 assets consist of commingled funds in which the underlying assets are primarily marketable debt and equity securities that trade on nationally recognized exchanges.

** Valuation techniques are described in Note 2.

The company has reclassified $67,447 in bonds that were previously reported as Level 1 at December 31, 2015 to Level 2. The changes had no impact on the accompanying combined financial statements.

Fair Value of Long-Term Debt

The fair value of long-term debt is estimated based upon published or quoted market prices (Level 2) for these issues or, where such prices not available, on similar issues and approximated $714,123 and $746,995 at December 31, 2016 and 2015, respectively.

(Dollar Amounts in Thousands)

8. Property and Equipment, Net

Property and equipment, net, consists of the following:

	December 31	
	2016	**2015**
Land and improvements	**$ 115,460**	$ 119,308
Buildings and improvements	**964,605**	943,047
Equipment	**552,333**	587,676
Software	**224,020**	208,604
	1,856,418	1,858,635
Less accumulated depreciation and amortization	**1,058,645**	1,034,725
	797,773	823,910
Construction-in-progress	**52,990**	33,138
	$ 850,763	$ 857,048

Unamortized software was $65,494 and $75,558 as of December 31, 2016 and 2015, respectively. Software amortization expense was $25,116 and $23,196 for the years ended December 31, 2016 and 2015, respectively, and is included in depreciation and amortization expense.

At December 31, 2016, PHS has future capital commitments of $112,124.

PHS capitalized interest costs in the amounts of $407 and $2,625 in 2016 and 2015, respectively.

9. Medical Claims Expense

For the years ended December 31, 2016 and 2015, medical claims expense decreased $26,243 and $12,245 in 2016 and 2015, respectively, as a result of changes in estimates of unpaid claims and claims adjustment expenses. These changes generally are the result of ongoing analyses of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

(Dollar Amounts in Thousands)

10. Long-Term Debt, Capital Leases, and Interest Rate Swaps

	December 31	
	2016	**2015**
2015 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.125% to 5.0% at December 31, 2016, payable semiannually on the established interest payment dates, principal payments beginning in 2016 through 2044	**$ 231,095**	$ 237,160
2012 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 4.0% to 5.0% at December 31, 2016, payable semiannually on the established interest payment dates, principal payments beginning in 2033 through 2042	**75,000**	75,000
2009 Series A Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), fixed-interest coupon rates from 5.0% to 5.125% at December 31, 2016, payable semiannually on the established interest payment dates, principal payments beginning in 2033 through 2039	**134,610**	134,610
2008 Series B, C, and D Hospital System Revenue Bonds (New Mexico Hospital Equipment Loan Council), variable-rate demand bonds with interest rate of .72% at December 31, 2016, payable monthly on the established interest payment date, principal payable in annual installments through 2034	**185,985**	193,150
2012 note payable to bank, variable rate, interest payable quarterly at one-month LIBOR plus .90% (1.5% at December 31, 2016) due October 2022	**50,000**	50,000
Capital lease obligations and other	**6,916**	12,116
	683,606	702,036
Premiums and (discounts) on long-term debt, net	**21,944**	22,733
Less deferred financing fees	**6,166**	6,437
	699,384	718,332
Less current portion	**14,677**	14,797
	$ 684,707	$ 703,535

10. Long-Term Debt, Capital Leases, and Interest Rate Swaps (continued)

The 2015 Series A Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council. Proceeds of the bonds were used to defease the 2008 Series A Bonds, reimburse PHS for prior capital expenditures and pay the costs of issuance. The remaining portion of the proceeds will be used to fund current and future capital projects. The 2015 bonds are fixed-rate serial and term bonds and have scheduled maturities and mandatory sinking fund deposits starting in August 2016 and August 2040, respectively, and continue through 2044.

The 2012 Series A Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council in August 2012. Proceeds of the bonds are being used to fund various health care facilities throughout the PHS system, including a patient tower at the Española Hospital, a cancer center on the Rust Medical Center campus, a physician office building adjacent to Socorro General Hospital, and other general capital improvements, and were also used to pay costs of issuance. The 2012 bonds are fixed-rate term bonds and have scheduled mandatory sinking fund deposits starting in 2013 and continuing through 2042. In August 2012, PHS also obtained a $50,000 taxable bank direct loan (the 2012 Bank Loan), of which $50,000 was outstanding as of December 31, 2016 and 2015. Proceeds of the 2012 Bank Loan were used for a new system corporate office, which was completed in 2014.

The 2009 Series A Revenue Bonds totaling $134,610 of original issue discount bonds were issued through the New Mexico Hospital Equipment Loan Council. Proceeds of the bonds were used to fund a project for the construction of the Rust Medical Center and pay the costs of issuance. The 2009 bonds are fixed-rate term bonds and have scheduled mandatory sinking fund deposits starting in 2033 and continue through 2039.

The 2008 Revenue Bonds were issued through the New Mexico Hospital Equipment Loan Council in four series (Series A, Series B, Series C, and Series D) (the Series 2008 Bonds) in November 2008. The Series 2008 Bonds were designed to defease the 2005 Series A and B Revenue Bonds ($201,895); to pay off a Wells Fargo Credit Agreement, which defeased the 2004 Series A through D Bonds ($128,655) and the 1993A Bonds ($17,900) during March and April 2008; to reimburse PHS for prior capital expenditures; and to pay certain costs of issuing the Series 2008 Bonds. The Series 2008 A Bonds were refunded in their entirety in 2015 and have been legally defeased. The Series 2008 B through D Bonds are variable-rate demand obligations and bear interest on a weekly rate period at amounts set by a remarketing agent. The

(Dollar Amounts in Thousands)

10. Long-Term Debt, Capital Leases, and Interest Rate Swaps (continued)

interest rate mode can be modified under the terms of the legal documents. To secure the tender price of the Series 2008 B Bonds, PHS has entered into standby bond purchase agreements with JPMorgan Chase Bank, N.A., and with Wells Fargo, N.A. for the Series 2008 C and D Bonds. The standby bond purchase agreements expire in November 2017, 2018, and 2019 for the Series 2008 B, C, and D Bonds, respectively.

The Series 2008 B, C, and D Bonds are subject to optional redemption at the discretion of PHS. In addition, the Series 2008 Bonds have a schedule of mandatory sinking fund deposits through 2034.

All of the outstanding bonds are collateralized by a pledge of unrestricted receivables of the Obligated Group, as defined under the Master Trust Indenture. The Master Trust Indenture of the Obligated Group requires, among other things, that certain funds be established and held by a trustee. The Master Trust Indenture also requires certain limitations on additional indebtedness, liens on property, and disposition or transfers of assets, as well as the maintenance of certain cash balances and other financial ratios. The Obligated Group was in compliance with all such covenants at December 31, 2015.

Scheduled principal payments and sinking fund requirements on long-term debt and capital leases at December 31 are as follows:

	Long-Term Debt
2017	$ 14,677
2018	15,205
2019	15,766
2020	16,423
2021	17,128
Thereafter	620,185
	$ 699,384

10. Long-Term Debt, Capital Leases, and Interest Rate Swaps (continued)

Interest Rate Swaps

In connection with the Series 2005 Bonds, PHS entered into two floating to fixed-rate swaps (the 2005 Swaps) effective July 28, 2005, for notional amounts of $102,400 and $102,600. On November 25, 2008, PHS refunded the Series 2005 Bonds with the Series 2008 B–D Bonds. The amortization schedule for the Series 2008 B–D Bonds was established to match the amortization of the Series 2005 Bonds. The 2005 Swaps provide that PHS receives a floating amount based on a percentage of one-month LIBOR (58.30% of LIBOR plus 0.36%) and PHS pays a fixed rate of 3.085% based on a notional amount equal to the principal amount of the Series 2005 Bonds. As of and subsequent to April 1, 2007, PHS recognizes the entire change in the fair value of these swaps within the excess of revenue over expenses under ASC 815, as discussed in Note 2. The total outstanding notional amount of the 2005 Swaps was $161,240 and $168,405 at December 31, 2016 and 2015, respectively.

On February 9, 2006, PHS entered into a series of four floating to fixed-rate, forward-dated swaps (the 2006 Swaps) in notional amounts of $38,695, $38,665, $31,460, and $25,720. The 2006 Swaps were effective January 2, 2007, and provide that PHS receives a floating amount based on a percentage of one-month LIBOR (68%) and PHS pays a weighted average fixed rate of 3.564% based on a notional amount equal to the principal amount of the Series 2004 Bonds. On June 5, 2009, PHS terminated the two 2006 Swaps that were initially originated in the notional amounts of $31,460 and $25,720 and partially terminated two of the 2006 Swaps that were initially originated in the notional amounts of $38,695 and $38,665. The remaining portion of the 2006 Swaps match the amortization schedule for the Series 2008 B–D Bonds that are not hedged by the 2005 Swaps. As of and subsequent to April 1, 2007, PHS recognizes the entire change in the fair value of these swaps within the excess of revenue over expenses under ASC 815, as discussed in Note 2. The total outstanding notional amount of the 2006 Swaps was $24,745 and $27,745 at December 31, 2016 and 2015, respectively.

All derivatives that are being measured by PHS under ASC 820 are considered Level 2 assets (liabilities) because a quoted price can be obtained from a number of dealer counterparties and other market sources based on observable interest rates and yield curves for the full term of the asset or liability. In order to measure the fair value of municipal derivatives under ASC 820, PHS adjusted its mid-market periodic values of the swaps outstanding to incorporate non-performance risk by PHS (when the financial instrument is a liability) or the counterparty (when the financial

10. Long-Term Debt, Capital Leases, and Interest Rate Swaps (continued)

instrument is an asset). In order to determine the risk of non-performance when the financial instrument is a liability, PHS has determined the change in the credit market for debt issues by entities with the same credit characteristics as PHS. To determine non-performance risk when the instrument is an asset, PHS determines the change in the credit market for debt issues by the counterparty.

As of December 31, 2016 and 2015, the fair value of the 2005 and 2006 Swaps was a net liability of $22,668 and $26,790, respectively, and is included in other liabilities on the accompanying combined balance sheets.

If the liability related to the swaps were to exceed $40,000, PHS would be required to post a cash deposit for amounts in excess of the threshold as collateral with the counterparty. This collateral threshold would be reduced to $30,000 if PHS's current AA credit rating were to fall to A+, reduced to $20,000 at a rating of A, and further reduced to zero at a credit rating below A.

Interest expense included $4,879 and $5,346 in 2016 and 2015, respectively, related to net periodic payments to the counterparty.

11. Employee Benefit Plans

PHS has a defined benefit pension plan (Plan I) that previously covered substantially all of the employees of its related organizations, except employees of PNI. Effective January 1, 2006, Plan I was closed to new entrants, but it continued to accrue benefits for those employees in the plan as of December 31, 2005 until December 31, 2012, when Plan I was amended to cease future benefit accruals. Any benefits earned by participants under Plan I at December 31, 2012, will be preserved and will be payable based on Plan I's provisions.

PHS contributes such amounts as necessary on an actuarial basis to provide Plan I with assets sufficient to meet the benefits to be paid to Plan I participants. PHS contributed $9,560 and $8,004 in 2016 and 2015, respectively, to Plan I.

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

A summary of Plan I's benefit obligation, assets, and funded status is as follows:

	Year Ended December 31	
	2016	**2015**
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 544,601**	$ 580,068
Service cost	**3,800**	2,100
Interest cost	**25,384**	24,767
Plan amendments	**17,372**	–
Plan settlements	**(77,820)**	–
Actuarial loss (gain)	**6,164**	(39,337)
Benefits paid and plan expenses	**(27,261)**	(22,997)
Benefit obligation at end of year	**$ 492,240**	$ 544,601
Change in assets:		
Fair value of assets at beginning of year	**$ 390,694**	$ 422,509
Actual return on assets	**37,934**	(16,822)
Employer contribution	**9,560**	8,004
Plan settlements	**(77,820)**	–
Benefits paid and plan expenses	**(27,261)**	(22,997)
Fair value of plan assets at end of year	**$ 333,107**	$ 390,694
Funded status at year-end	**$ (159,133)**	$ (153,907)
Amounts not yet reflected in net periodic benefit cost and included in net assets:		
Accumulated loss	**$ (164,657)**	$ (178,285)
Cumulative changes in unrestricted net assets	**(164,657)**	(178,285)
Cumulative employer contributions in excess of net periodic benefit cost	**5,524**	24,378
Net amount recognized in the combined balance sheets	**$ (159,133)**	$ (153,907)

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

The actuarial gain recorded in 2015 was primarily due to PHS using new mortality tables in the projected benefit obligation calculation. The actuarial loss recorded in 2016 was primarily due to PHS using the 2016 mortality tables. New mortality tables were issued by the Society of Actuaries during 2015 and 2016.

PHS recorded a 2016 year settlement charge of $24,176 for the risk transfer activities that occurred in 2016. This settlement charge is in addition to the regular periodic benefit cost of $4,236. These risk transfer activities are also the primary cause for the decrease on both pension obligation and assets during 2016.

A summary of the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets is as follows:

	2016	2015
Projected benefit obligation	**$ 492,240**	$ 544,601
Accumulated benefit obligation	**492,240**	544,601
Fair value of plan assets	**333,107**	390,694

Net periodic benefit cost includes the following components:

	2016	2015
Service cost – benefits earned during the year	**$ 3,800**	$ 2,100
Interest cost on projected benefit obligation	**25,384**	24,767
Expected return on Plan I assets	**(28,368)**	(29,842)
Amortization of prior service credit	**–**	–
Recognized net actuarial loss	**3,420**	4,326
Net periodic pension benefit cost	**$ 4,236**	$ 1,351

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Assumptions used to determine benefit obligation as of the measurement date are as follows:

	2016	2015
Discount rate at end of year	**4.62%**	4.75%
Rate of increase in compensation levels	**N/A**	N/A

Assumptions used to determine net periodic pension benefit cost are as follows:

	2016	2015
Discount rate at beginning of year	**4.75%**	4.34%
Rate of increase in compensation levels	**N/A**	N/A
Expected long-term rate of return on assets	**7.0%**	7.50%

Contributions to be made during 2017 have not been finalized, but are expected to be $13,200.

The expected return on Plan I assets has been developed using both historical and future expected returns for each asset class. Based on the target asset mix as of December 31, 2016, PHS has selected a long-term rate of return of 6.75% using this approach.

The asset allocation for Plan I by asset class at the measurement date was as follows:

	2016	2015
Cash and cash equivalents	**2%**	1%
Fixed-income securities	**38**	45
Common stock and equity	**49**	44
Absolute return, hedge funds, and other	**11**	10
	100%	100%

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

Plan I assets have historically been invested in a portfolio designed to preserve principal and obtain competitive investment returns and long-term investment growth, consistent with actuarial assumptions, while minimizing unnecessary investment risk. Diversification is achieved by retaining multiple investment managers with complementary philosophies, styles, and approaches.

Plan I asset allocation targets at the measurement date were as follows:

	Target	Range
Cash and cash equivalents	1%	0%–6%
Fixed-income securities	44	39–49
Domestic equity securities	20	15–25
International equity securities	20	15–25
Other	15	7–25

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

The fair values of PHS's Plan I assets at December 31, by asset category, are as follows:

Asset Category	Level 1	Level 2	Level 3	Carrying Value	Valuation Technique (a, b, c)*
2016					
Money market	**$ 6,792**	**$ –**	**$ –**	**$ 6,792**	**a**
Bond funds	**17,189**	**108,543**	**–**	**125,732**	**a/c**
Public master limited partnership	**20,573**	**–**	**–**	**20,573**	**a**
Equity funds	**79,233**	**63,216**	**–**	**142,449**	**a**
Alternative investments	**–**	**–**	**37,561**	**37,561**	**a/c**
	$ 123,787	**$ 171,759**	**$ 37,561**	**$ 333,107**	
2015					
Money market	$ 3,337	$ –	$ –	$ 3,337	a
Bond funds	17,682	157,308	–	174,990	a/c
Public master limited partnership	17,711	–	–	17,711	a
Equity funds	83,645	69,754	–	153,399	a
Alternative investments	–	–	41,257	41,257	a/c
	$ 122,375	$ 227,062	$ 41,257	$ 390,694	

* Valuation techniques are described in Note 2.

Expected benefits to be paid to the Plan I participants and beneficiaries are as follows:

2017	$ 18,904
2018	20,138
2019	21,810
2020	23,235
2021	24,592
2021–2025	142,027

(Dollar Amounts in Thousands)

11. Employee Benefit Plans (continued)

In addition to Plan I, PHS also has five other limited postretirement benefit plans subject to the funded status recognition provisions of ASC 715. Plan I is funded, and the other postretirement plans are unfunded. During 2016, unrestricted net assets increased by approximately $13,188, and during 2015, unrestricted net assets decreased by $2,015 for changes in the funded status of Plan I and the other postretirement benefit plans.

PHS has a defined contribution Plan (Plan II), which consists of a Section 403(b) plan and a Section 401(a) plan under the Code. Plan II requires PHS to pay a basic employer contribution, as well as match participant contributions up to a stated maximum percentage of the participant's salary. Contributions to Plan II are expensed as earned by employees and were $26,985 and $25,697 in 2016 and 2015, respectively.

PHP has a 401(k) defined contribution plan (Plan III) for PHP employees. Plan III requires PHP to match participant contributions up to a stated maximum percentage of the participant's salary. Plan III additionally provides an employer contribution for all employees regardless of whether the employee individually contributes to the Plan III. PHP contributions to Plan III are expensed as earned by employees and were $2,678 and $2,404 in 2016 and 2015, respectively.

12. Restricted Net Assets

Permanently or temporarily restricted net assets are recorded in accordance with the intent of the donor. Restricted net assets are available for the following purposes as of December 31:

	2016		**2015**	
	Temporarily	**Permanently**	**Temporarily**	**Permanently**
Program services and facility improvements	**$ 24,245**	**$ 9,567**	$ 22,435	$ 9,218
Education	**3,881**	**1,653**	3,562	1,633
	$ 28,126	**$ 11,220**	$ 25,997	$ 10,851

(Dollar Amounts in Thousands)

13. Concentration of Credit Risk

PHS provides health care services through its inpatient and outpatient care facilities throughout New Mexico. PHS grants credit to patients, most of whom are insured under third-party payor agreements, without requiring collateral or other security in extending credit to patients. However, PHS routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs and commercial insurance policies). The following table summarizes the percentage of net patient accounts receivable from all payors:

	December 31	
	2016	**2015**
Managed care and other third-party payors	**72%**	71%
Government	**22**	23
Self-pay	**6**	6
Total	**100%**	100%

Managed care and other third-party payors consist of receivables from various payors, including contracted third-party payors providing commercial and government programs. Management does not believe there is any significant concentration of credit risks associated with accounts receivable. Furthermore, management continually monitors and adjusts its allowances (contractual and doubtful accounts) associated with these receivables.

14. Commitments and Contingencies

Litigation and Other Contingent Liabilities

PHS is subject to pending and threatened legal actions arising during the ordinary course of business. Management and legal counsel periodically assess whether losses have been incurred related to pending or threatened litigation, claims, and assessments. Loss estimates are continually monitored and reviewed, and as estimates are adjusted, changes in estimated losses are reflected in current operations. Losses incurred due to the actual results of litigation could differ from estimates recorded. In management's opinion, upon consultation with legal counsel, these matters

14. Commitments and Contingencies (continued)

should not have a material adverse effect on PHS's combined financial condition, results of operations, or cash flows. However, PHS's evaluation of the likely effects of these actions could change in the future, and an unfavorable outcome, depending upon the amount and timing, could have a material effect on PHS's combined results of operations or cash flows of a future period.

Patient Protection and Affordable Care Act

The ACA, signed into law on March 23, 2010, has created significant changes and will continue to create significant changes for health insurance markets, including changes to Medicare Advantage payments and the Medical Loss Ratio (MLR) provision that requires insurers to pay rebates to customers when insurers do not meet or exceed the specified MLR thresholds. Most of the provisions of ACA with more significant effects on the health insurance marketplace, both state and federal, went into effect on January 1, 2014, including a requirement that insurers guarantee the issuance of coverage to all individuals regardless of health status, strict rules on how health insurance is rated, the assessment of new taxes and fees (including annual fees on health insurance companies), the creation of new insurance exchanges for individuals and small groups, the availability of premium subsidies for certain individual products, and substantial expansions in eligibility for Medicaid. Implementation of ACA brings with it significant oversight responsibilities by health insurers that may result in increased governmental audits, increased assertions of False Claims Act violations, and an increased risk of other litigation.

Despite significant preparation for the advent of the new federal and state health insurance exchanges, there have been many technical difficulties in the implementation of the exchanges, which entail uncertainties associated with mix and volume of business. In November 2013, CMS notified the various state insurance commissioners that, under a transitional policy, health insurance coverage in the individual or small group market that is renewed for a policy year starting between January 1, 2014 and October 1, 2014, and that would otherwise have been deemed non-compliant with certain market reforms under Health Care Reform, will nonetheless not be considered by CMS to be out of compliance with respect to such market reforms, provided certain conditions are met. CMS further encouraged state agencies responsible for enforcing the specified market reforms to adopt the same transitional policy with respect to this coverage. The state of New Mexico has taken the position that individual policies have no transition period and should be renewed to be compliant by January 1, 2015. For small group policies, the state has taken the position of allowing a transition period through December 31, 2015, and policies must be renewed to be compliant by January 1, 2016.

14. Commitments and Contingencies (continued)

Due to the impact of the transitional policy, PHS may be adversely selected by individuals who will have a higher acuity level than the anticipated pool of participants in the exchange markets. In addition, the risk adjustment, reinsurance, and risk corridor premium stabilization programs of Health Care Reform, or Health Care Reform Premium Stabilization Programs, established to apportion risk among insurers, may not be effective in appropriately mitigating the financial risks related to PHS's exchange products. These factors, along with the limited information about the individuals who have access to these newly established exchanges that was available when PHS established premiums, may have a material adverse effect on PHS's combined results of operations if premiums are not adequate or do not appropriately reflect the acuity of these individuals. Any variation from PHS's expectations regarding acuity, enrollment levels, adverse selection, or other assumptions utilized in setting adequate premium rates could have a material adverse effect on PHS's combined results of operations, financial position, and cash flows.

Health Insurer Fee

Due to the Affordable Care Act Health Insurer Industry Fee, there was a special surplus adjustment of $29,327 in 2015 relative to the 2016 reporting year. However, the fee was suspended for 2017 so no special surplus is required for 2016.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in exclusion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed and paid. Management believes that it has established adequate reserves to investigate, defend, and ultimately resolve any alleged instances of noncompliance. Compliance with such laws and regulations can be subject to future government review, as well as regulatory actions unknown or unasserted at this time.

14. Commitments and Contingencies (continued)

Self-Insurance Plans

PHS is self-insured for professional and general liability, workers' compensation, and employee health insurance. PHS purchases claims-made insurance to cover professional liability and workers' compensation claims in excess of the self-insured limits. There are known claims and incidents that may result in the assertion of additional claims, as well as claims for unknown incidents that may be asserted arising from services provided to patients. PHS has engaged independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued professional liability, general liability, and workers' compensation losses of $118,405 and $139,794 at December 31, 2016 and 2015, respectively, have been discounted at 2.65% and 2.72%, respectively, and in management's opinion, such amounts provide an adequate reserve for loss contingencies. The decrease in the accrued liability can be attributed to claims final settling in the year, offset by adverse claim development. The accrued liability relating to professional and general liability and workers' compensation at December 31, 2016 and 2015 is reported on a gross basis and, therefore, has not been reduced by estimated insurance recoveries of $12,330 and $21,326, respectively, which are reported in other receivables. The accrued liability for estimated employee health claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and totaled $4,382 and $5,298 at 2016 and 2015, respectively.

At December 31, 2016 and 2015, PHS had an available line of credit to collateralize the workers' compensation coverage of $9,300, of which none was outstanding.

Surety Bond

The Medicaid Centennial Care Contract requires PHP to provide a performance bond equal to 90% of the average of the past three months capitation payments made to PHP from HSD. As of December 31, 2016 and 2015, PHP met this requirement through a surety bond issued by an unrelated insurance company in the amount of $96,662 and $90,245, respectively. PHP has indemnified the issuer of the bond for any and all losses.

(Dollar Amounts in Thousands)

14. Commitments and Contingencies (continued)

Operating Leases

Future minimum rental payments required for the next five years and thereafter for all operating leases that have initial or remaining noncancelable lease terms in excess of one year at December 31, 2016 are as follows:

2017	$ 2,022
2018	1,842
2019	1,823
2020	463
2021	10
Thereafter	602
	$ 6,762

Rent expense under operating leases for the years ended December 31, 2016 and 2015 totaled $5,380 and $8,303, respectively.

15. Functional Expenses

PHS provides general health care services to residents within its geographic region. Expenses related to providing these services are as follows:

	Year Ended December 31	
	2016	**2015**
Health care services	**$ 2,528,596**	$ 2,318,284
Non-clinical and support services, including general and administrative	**532,618**	451,656
	$ 3,061,214	$ 2,769,940

(Dollar Amounts in Thousands)

16. Income Taxes

The components of the provision for income taxes at December 31 are as follows:

	2016	2015
Current	**$ 25,454**	$ 43,783
Deferred	**(660)**	(8,697)
Total provision for income taxes	**$ 24,794**	$ 35,086

The differences between the actual and expected provision for income taxes or benefit computed by applying the federal corporate income tax rate of 35% in 2016 and 2015, plus a state rate of 4.8% for PNI operations only, to income before income taxes for the years ended December 31 are as follows:

	2016	2015
Computed tax expense at combined rate	**$ 14,647**	$ 24,237
PPACA health provider fee	**10,264**	10,968
Change in valuation allowance	**266**	(147)
Other permanent differences	**(256)**	(466)
Provision to return differences	**(41)**	303
State taxes and other	**(86)**	191
	$ 24,794	$ 35,086

(Dollar Amounts in Thousands)

16. Income Taxes (continued)

Deferred tax assets (liabilities) were comprised of the following at December 31:

	2016	**2015**
Deferred tax assets:		
Medical liabilities and other reserves	**$ 3,499**	$ 4,213
Medical claims payable (incurred but not reported)	**376**	417
Premium deficiency reserve	**1,171**	7,190
Deferred compensation	**693**	840
Premium tax settlement	**4,900**	–
Investments	**496**	424
Unrealized loss on investments	**1,496**	1,044
Net operating loss carryforwards	**807**	541
Total deferred tax assets	**13,438**	14,669
Deferred tax liabilities:		
Amortization of intangibles	**(21,220)**	(20,462)
Prepaid insurance	**(142)**	(2,869)
Depreciation	**(24)**	(36)
Partnership – book/tax difference	**(213)**	(255)
Gains on sale of securities	**(936)**	(1,167)
Unrealized gains on investments	**(5,518)**	(5,420)
Total deferred tax liabilities	**(28,053)**	(30,209)
Valuation allowance	**(807)**	(541)
Deferred tax liabilities, net	**$ (15,422)**	$ (16,081)

At December 31, 2016 and 2015, PNI had no federal net operating loss carryforwards. PNI is subject to state income tax and has state net operating loss carryforwards at December 31, 2016 and 2015 of $16,803 and $11,273, respectively, of which a portion is expiring each year.

At December 31, 2016 and 2015, a valuation allowance in the amount of $807 and $541, respectively, was established against the deferred tax asset related to the state net operating loss carryforwards, as management currently believes that the benefit from some or all of this deferred tax asset may not be realized.

In the normal course of business, PNI is subject to examination by taxing authorities, and PNI is no longer subject to U.S. federal, state, or local income tax examinations for years before 2012. PNI does not have any current federal tax disputes.

Supplementary Information

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Building a better working world

Report of Independent Auditors on Supplementary Information

The Board of Directors
Presbyterian Healthcare Services

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The combining balance sheet and statement of operations for the year ended December 31, 2016, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements, or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

Ernst & Young LLP

April 21, 2017

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet

December 31, 2016

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Assets					
Current assets:					
Cash and cash equivalents	$ 120,931	$ 180,243	$ 856	$ –	$ 302,030
Accounts receivable, net	135,811	–	5,914	(21,524)	120,201
Other receivables	44,003	96,691	873	(20,533)	121,034
Estimated third-party payor receivable	(438)	–	4,462	–	4,024
Inventories, prepaid expenses, and other current assets	32,500	14,267	1,195	–	47,962
Total current assets	332,807	291,201	13,300	(42,057)	595,251
Assets limited as to use or restricted:					
Designated for long-term purposes	1,454,416	380,485	565	–	1,835,466
Designated for self-insurance funds	127,749	–	–	–	127,749
Restricted by donors	38,274	–	–	–	38,274
Held by trustee	23,757	–	–	–	23,757
Restricted for statutory requirements	–	116,962	–	–	116,962
	1,644,196	497,447	565	–	2,142,208
Property and equipment, net	813,925	161	36,677	–	850,763
Goodwill	3,125	52,501	–	–	55,626
Intercompany (payables) receivables	(12,127)	10,284	36,356	(34,513)	–
Other assets	58,425	(28,955)	138,342	(80,365)	87,447
Total assets	$2,840,351	$ 822,639	$ 225,240	$ (156,935)	$ 3,731,295

Presbyterian Healthcare Services and Affiliates

Combining Balance Sheet (continued)

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Liabilities and net assets					
Current liabilities:					
Accounts payable	$ 53,292	$ 5,219	$ 1,419	$ –	$ 59,930
Due under Medicaid contract	–	186,390	–	–	186,390
Accrued liabilities	143,244	69,093	6,006	(38,429)	179,914
Medical claims payable	–	140,070	–	(3,628)	136,442
Current portion of long-term debt and capital leases	14,677	–	–	–	14,677
Total current liabilities	211,213	400,772	7,425	(42,057)	577,353
Long-term debt and capital leases, net of current portion	684,707	–	–	–	684,707
Employee benefit plans	206,041	–	–	–	206,041
Self-insurance plans	122,787	–	–	–	122,787
Other liabilities	72,234	27,562	1,879	–	101,675
Total liabilities	1,296,982	428,334	9,304	(42,057)	1,692,563
Net assets:					
Unrestricted	1,504,023	394,305	215,936	(114,878)	1,999,386
Temporarily restricted	28,126	–	–	–	28,126
Permanently restricted	11,220	–	–	–	11,220
Total net assets	1,543,369	394,305	215,936	(114,878)	2,038,732
Total liabilities and net assets	$2,840,351	$ 822,639	$ 225,240	$ (156,935)	$ 3,731,295

Presbyterian Healthcare Services and Affiliates

Combining Statement of Operations

Year Ended December 31, 2016

	Obligated Group	Presbyterian Network, Inc.	Other Non-Obligated Group Members	Eliminations	Combined
			(In Thousands)		
Revenues:					
Net premiums	$ 434,545	$ 2,040,064	$ –	$ (427,389)	$ 2,047,220
Patient service revenue	1,327,366	–	61,729	(315,341)	1,073,754
Less provision for doubtful accounts	(50,041)	–	(3,010)	–	(53,051)
Net patient service revenue	1,277,325	–	58,719	(315,341)	1,020,703
Other operating revenues	69,778	30,669	10,085	(42,327)	68,205
Total operating revenues	1,781,648	2,070,733	68,804	(785,057)	3,136,128
Expenses:					
Medical claims	224,355	1,738,521	–	(744,256)	1,218,620
Salaries, wages, and employee benefits	813,549	79,759	29,523	(5,783)	917,048
Purchased services and other	264,018	225,371	22,965	(35,018)	477,336
Supplies	278,877	635	1,698	–	281,210
Professional fees	41,014	3	2,079	–	43,096
Depreciation and amortization	90,605	324	5,004	–	95,933
Interest	27,936	–	35	–	27,971
Total expenses	1,740,354	2,044,613	61,304	(785,057)	3,061,214
Operating income	41,294	26,120	7,500	–	74,914
Other income (loss):					
Investment income	56,347	16,678	1,110	–	74,135
Changes in unrealized gains (losses) on investments	54,040	(953)	–	–	53,087
Pension setlement	(24,176)	–	–	–	(24,176)
Change in fair value of interest rate swaps	4,186	–	–	–	4,186
Total other income	90,397	15,725	1,110	–	107,232
Excess of revenues over expenses before income taxes	131,691	41,845	8,610	–	182,146
Provision for income taxes	–	24,702	92	–	24,794
Excess of revenues over expenses	$ 131,691	$ 17,143	$ 8,518	$ –	$ 157,352

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Annual Operating Information

Presbyterian Hospitals

Name of Hospital	Location	Year of Affiliation	Number of Beds[1] as of December 31, 2016: Licensed	Number of Beds[1] as of December 31, 2016: Staffed
Owned Hospitals:				
Presbyterian Hospital	Albuquerque	1908	543	483
Presbyterian Kaseman Hospital	Albuquerque	1970	150	100
Presbyterian Rust Medical Center	Rio Rancho	2011	167	135
Plains Regional Medical Center	Clovis	1975	118	118
Española Hospital	Española	1977	80	68
Socorro General Hospital	Socorro	1976	30	29
Subtotal			1,088	933
Leased Hospitals:				
Lincoln County Medical Center	Ruidoso	1972	28	28
Dr. Dan C. Trigg Memorial Hospital	Tucumcari	1976	25	25
Subtotal			53	53
Total			1,141	986

[1] Bed figures include licensed hospice beds, skilled nursing beds and bassinets.

Presbyterian Healthcare Services
All Hospitals
Operating Disclosure Data

	Year Ended				
	2012	**2013**	**2014**	**2015**	**2016**
Hospital Data					
Total Inpatient Discharges	51,429	53,216	53,078	52,218	54,100
Newborn Discharges	7,302	7,191	6,791	6,787	6,621
Inpatient Surgery Discharges	10,609	10,916	10,536	10,540	11,364
Open Heart Surgery Discharges	432	440	427	405	414
ER Visits Resulting in an Admit	21,397	22,848	25,379	25,528	27,045
Observation Discharges	6,111	5,488	8,404	10,471	9,877
Total Inpatient Days	217,356	234,465	235,817	232,121	242,227
Newborn Days	29,868	28,598	28,649	27,622	28,739
Inpatient Surgery Days	51,962	54,389	55,755	53,804	57,332
Total Outpatient Visits	551,538	556,958	600,966	634,476	661,620
ER Visits	202,849	212,023	228,789	242,964	251,766
OP Surgeries	22,039	22,993	23,043	22,515	21,946
Licensed Beds	1,173	1,171	1,151	1,086	1,141
Beds in Service	977	973	973	947	986
Average Length of Stay (days)	4.23	4.41	4.44	4.45	4.48
Percentage Occupancy (of beds in service)	61.1%	66.0%	66.4%	67.1%	67.1%
Medicare Case Mix Index	1.47	1.57	1.45	1.38	1.45
PMG Albuquerque Visits	1,305,928	1,481,555	1,670,274	1,842,565	1,930,836

Presbyterian Healthcare Services
Obligated Group
Operating Disclosure Data

	Year Ended				
	2012	**2013**	**2014**	**2015**	**2016**
Hospital Data					
Total Inpatient Discharges	49,413	51,202	51,033	50,243	52,384
Newborn Discharges	6,903	6,828	6,455	6,428	6,330
Inpatient Surgery Discharges	10,270	10,615	10,354	10,312	11,162
Total Inpatient Days	212,215	229,267	230,320	226,560	237,110
Newborn Days	29,250	28,080	28,160	27,087	28,311
Inpatient Surgery Days	51,048	53,640	55,237	53,246	56,756
Total Outpatient Visits	504,154	511,081	556,080	589,913	614,053
ER Visits	183,913	193,740	211,041	224,845	232,639
OP Surgeries	20,719	21,580	22,206	21,953	21,417
Licensed Beds	1,120	1,118	1,098	1,033	1,088
Beds in Service	924	920	920	894	933
Average Length of Stay (days)	4.29	4.48	4.51	4.51	4.53
Percentage Occupancy (of beds in service)	63.1%	68.3%	68.6%	69.4%	69.4%
Medicare Case Mix Index	1.49	1.59	1.47	1.40	1.47

Presbyterian Healthcare Services
Central New Mexico
Operating Disclosure Data

	Year Ended				
	2012	**2013**	**2014**	**2015**	**2016**
Hospital Data					
Total Inpatient Discharges	39,804	41,979	42,261	41,791	44,466
Newborn Discharges	5,185	5,091	4,787	4,798	4,726
Inpatient Surgery Discharges	8,479	8,849	8,828	8,827	9,694
Total Inpatient Days	183,812	195,080	204,265	202,225	213,616
Newborn Days	25,983	24,664	24,915	24,097	25,337
Inpatient Surgery Days	43,685	47,169	49,305	47,749	51,494
Total Outpatient Visits	352,370	377,044	405,620	433,817	453,736
ER Visits	123,209	133,068	146,379	157,723	171,000
OP Surgeries	15,978	17,170	18,244	18,841	18,423
Licensed Beds	882	886	882	801	860
Beds in Service	691	693	711	692	718
Average Length of Stay (days)	4.62	4.65	4.83	4.84	4.80
Percentage Occupancy (of beds in service)	73.1%	77.1%	78.9%	80.1%	81.3%
Medicare Case Mix Index	1.55	1.62	1.54	1.48	1.54

Presbyterian Healthcare Services
Regional Hospitals
Operating Disclosure Data

Year Ended

	2012	2013	2014	2015	2016
Hospital Data					
Total Inpatient Discharges	11,625	11,237	10,817	10,427	9,634
Newborn Discharges	2,117	2,100	2,004	1,989	1,895
Inpatient Surgery Discharges	2,130	2,067	1,708	1,713	1,670
Total Inpatient Days	33,544	39,385	31,552	29,896	28,611
Newborn Days	3,885	3,934	3,734	3,525	3,402
Inpatient Surgery Days	8,277	7,220	6,450	6,055	5,838
Total Outpatient Visits	199,168	179,914	195,346	200,659	207,884
ER Visits	79,640	78,955	82,410	85,241	87,534
OP Surgeries	6,061	5,823	4,799	3,674	3,523
Licensed Beds	291	285	269	285	281
Beds in Service	286	280	262	255	268
Average Length of Stay (days)	2.89	3.50	2.92	2.88	2.97
Percentage Occupancy (of beds in service)	32.2%	38.5%	33.0%	32.1%	29.2%
Medicare Case Mix Index	1.14	1.21	1.04	0.99	1.05

Presbyterian Healthcare Services
PHP Membership
Operating Disclosure Data

	Year Ended				
	2012	**2013**	**2014**	**2015**	**2016**
PHP Membership					
Commercial	98,926	95,569	86,760	77,716	85,667
Medicare Advantage	34,040	36,902	38,852	42,585	45,564
Medicaid	166,222	163,502	193,114	213,116	226,897
Administrative Services Only	117,414	123,940	124,329	121,159	116,492
Total PHP Membership	416,602	419,913	443,055	454,476	474,620

Presbyterian Healthcare Services
Payor Mix Based on Net Revenue
All Facilities

	2012	2013	2014	2015	2016
COMMERCIAL	46.3%	46.4%	44.8%	43.1%	42.2%
MEDICAID	16.6%	15.7%	19.8%	21.5%	21.8%
MEDICARE	30.0%	31.7%	29.7%	30.3%	31.2%
OTHER	4.7%	4.1%	4.2%	3.8%	3.6%
SELF PAY	2.4%	2.1%	1.5%	1.3%	1.2%

Presbyterian Healthcare Services
Payor Mix Based on Net Revenue
Obligated Group

	2012	2013	2014	2015	2016
COMMERCIAL	46.6%	46.8%	44.2%	43.3%	42.3%
MEDICAID	16.4%	15.6%	19.7%	21.2%	21.5%
MEDICARE	29.9%	31.5%	29.5%	30.4%	31.4%
OTHER	4.8%	4.1%	4.1%	3.9%	3.6%
SELF PAY	2.3%	2.0%	2.5%	1.2%	1.2%

Historic and Pro Forma Coverage of Maximum Annual Debt Service
of the Obligated Group
(dollars in thousands)

	Years Ended December 31				
	2012	2013	2014	2015	2016
Income available for debt service:					
Excess of revenues over expenses	$ 137,980	$ 185,637	$ 103,050	$ (6,587)	$ 131,691
Plus: Depreciation and amortization	77,959	80,579	86,379	88,805	90,605
Plus: Interest	23,925	24,135	25,662	24,827	27,936
Plus: Loss on bond defeasance	-	-	-	24,061	-
Plus: Pension settlement	-	-	-	-	24,176
Plus: Changes in unrealized gains and losses on investments, loss on bond defeasance and change in fair market value of swaps	(67,499)	(71,968)	48,263	98,157	(58,226)
Total income available for debt service	$ 172,365	$ 218,383	$ 263,354	$ 229,263	$ 216,182
Maximum annual debt service ("MADS")	$ 39,758	$ 39,758	$ 39,758	$ 43,591	$ 43,591
Coverage of Historic MADS	4.3	5.5	6.6	5.3	5.0

Debt to Capitalization of the Obligated Group
(dollars in thousands)

	As of December 31				
	2012	2013	2014	2015	2016 (4)
Series 2008A Bonds	145,404	140,798	135,912	-	-
Series 2008B Bonds	70,513	68,359	66,139	63,853	61,491
Series 2008C Bonds	70,513	68,359	66,139	63,853	61,491
Series 2008D Bonds	70,522	68,370	66,150	63,862	61,506
Series 2009A Bonds (1)	130,515	130,669	130,822	130,977	131,131
Series 2012A Bonds (2)	77,552	77,466	77,379	77,293	77,207
Series 2015A Bonds (3)	-	-	-	256,379	249,642
Note payable to bank	15,000	41,000	50,000	50,000	50,000
Other, including capital lease obligations and other long term debt	10,565	8,854	11,341	12,116	6,916
Subtotal	590,584	603,875	603,882	718,333	699,384
Less current portion	13,064	12,973	13,435	14,797	14,677
Total long-term debt	577,520	590,902	590,447	703,536	684,707
Unrestricted net assets	842,323	1,374,812	1,367,161	1,358,946	1,504,023
Total Capitalization	$ 1,419,843	$ 1,965,714	$ 1,957,608	$ 2,062,482	$ 2,188,730
Long-term debt to capitalization	41%	30%	30%	34%	31%

(1) Amount is net of discounts. The outstanding par amount of the Series 2009A Bonds is $134,610,000.

(2) Amount includes preminums. The outstanding par amount of the Series 2012A Bonds is $75,000,000.

(3) Amount includes premiums. The outstanding par amount of the Series 2015A Bonds is $237,160,000.

(4) Amounts are net of Cost of Issuance upon adoption of new accounting pronouncement. Prior years have been restated to conform with the 2016 presentation.

Obligated Group Financial Indicators

Year Ended December 31

		2012	2013	2014	2015	2016
Operating Margin		1.3%	2.7%	2.8%	3.5%	2.3%
Excess Margin	(1)	9.3%	11.4%	6.3%	-0.4%	7.0%
Adjusted Excess Margin	(2)	5.0%	7.3%	9.0%	6.6%	5.3%
Unrestricted days cash on hand		307	353	359	338	349
Debt to cash flow		4.0	3.1	2.6	3.5	3.7

(1) Includes investment income, changes in unreallized gains and losses on investments, loss on bond defeasance, pension settlement and change in fair market value of interest rate swaps relating to the Series 2008B/C/D Bonds

(2) Excludes changes in unrealized gains and losses on investments, loss on bond defeasance, pension settlement and change in fair market value of interest rate swaps relating to the Series 2008 B/C/D Bonds.

Presbyterian Healthcare Services and Affiliates

Summary Combined Balance Sheet of the Obligated Group

December 31, 2016 and 2015

	2016	2015
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 120,931	115,258
Accounts receivable, net	135,811	128,753
Other receivables	44,003	64,068
Inventories, prepaid expenses and other	32,062	30,813
Total current assets	332,807	338,892
Assets limited as to use or restricted:		
Designated for long-term purposes	1,454,416	1,319,336
Designated for self-insurance funds	127,749	119,338
Restricted by donors	38,274	34,807
Held by trustee	23,757	51,838
	1,644,196	1,525,319
Property and equipment, net	813,925	816,554
Goodwill	3,125	3,125
Other assets and Intercompany Balances	46,298	49,060
Total assets	2,840,351	2,732,950
Liabilities and net assets		
Current liabilities:		
Accounts payable	$ 53,292	51,800
Accrued liabilities	143,244	140,236
Estimated third-party payer settlements	-	1,731
Current portion of long-term debt and capital leases	14,677	14,797
Total current liabilities	211,213	208,564
Long-term debt and capital leases, net of current portion	684,707	709,972
Pension liability	206,041	198,511
Other liabilities	195,021	220,109
Total liabilities	1,296,982	1,337,156
Net assets:		
Unrestricted	1,504,023	1,358,946
Temporarily restricted	28,126	25,997
Permanently restricted	11,220	10,851
Total net assets	1,543,369	1,395,794
Total liabilities and net assets	$ 2,840,351	2,732,950

Presbyterian Healthcare Services and Affiliates

Summary Combined Income Statement of the Obligated Group

	For the Year Ended 12/31/2016	12/31/2015
	(In Thousands)	
Revenues		
Net premium	$ 434,545	406,943
Patient service	1,327,366	1,273,838
Provisions for bad debts	(50,041)	(53,500)
Net patient service	1,277,325	1,220,338
Other operating	69,778	69,712
Total operating revenues	1,781,648	1,696,993
Expenses		
Medical claims	224,355	199,925
Salaries, wages and employee benefits	813,549	774,786
Purchased services and other	264,018	274,012
Professional fees	41,014	35,719
Supplies	278,877	239,275
Depreciation and amortization	90,605	88,805
Interest	27,936	24,827
Total expenses	1,740,354	1,637,349
Operating income	41,294	59,644
Other income:		
Investment income	56,347	55,987
Changes in unrealized gains on investments	54,040	(98,008)
Pension settlement	(24,176)	-
Loss on bond defeasance	-	(24,061)
Change in fair value of interest rate swaps	4,186	(149)
Total other income	90,397	(66,231)
Excess of revenues over expenses before income taxes	131,691	(6,587)
Provision for income taxes	-	-
Excess of revenues over expenses	$ 131,691	(6,587)

Results of Operations

Quarters Ended December 31, 2016 and 2015

For the three month period ended December 31, 2016 total operating income decreased by ($5.1) million to an operating loss of ($10.6) million ((1.3%) operating margin) from an operating loss of ($5.5) million ((0.8%) operating margin) in 2015.

Total operating revenue for the three month period ended December 31, 2016 increased by $60.9 million to $784.9 million from $724.0 million in 2015 driven primarily by a 13.7%, or $61.2 million increase in net premium revenue in the health plan. Presbyterian Health Plan (PHP) covered 226,897 members under the Centennial Care program as of December 31, 2016, up from 213,116 at December 31, 2015, a 6.5% increase. Overall at-risk Health Plan membership (excluding administrative services only (ASO) membership) increased 7.8% over the membership at December 31, 2015, and includes a 35.6% increase in individual membership, a 6.5% increase in Medicaid, a 7.0% increase in Medicare, and a 5.4% increase in Commercial. Net patient service revenue increased $5.3 million or 2.1% during the fourth quarter to $261.8 million compared to $256.5 million in 2015, which includes a $2.7 million or 1.0% increase in patient service revenue and a ($2.6) million or (19.9%) decrease in provision for bad debts. The decrease in bad debt expense in the fourth quarter of 2016 is the result of a change in the process of assisting uninsured patients with Medicaid enrollment and a presumptive charity care policy that was implemented late in 2016. This decrease is substantially offset by higher contractual allowances included in gross patient service revenue.

During the quarter ended December 31, 2016, total inpatient discharges for PDS increased by 6.3% or 793 discharges compared to the fourth quarter of 2015 while total inpatient days increased by 5.7% or 3,254 days. Total outpatient visits increased by 1.3% or 2,129 visits.

Inpatient discharges for the Obligated Group increased by 6.8% or 829 discharges in the fourth quarter of 2016 compared to the fourth quarter of 2015 and inpatient days increased by 3,166 days or 5.7%. Outpatient visits increased by 1.4% or 2,080 visits.

Inpatient discharges within CDS increased during the quarter ended December 31, 2016 compared to 2015 by 8.7% or 889 discharges. Inpatient Days increased from prior year by 6.1% or 3,021 days. Total outpatient visits in CDS increased from the prior year fourth quarter by 1.3% or 1,466 visits.

Inpatient discharges in RDS decreased in the quarter ended December 31, 2016 compared to 2015 by (3.9%) or (96) discharges. Total inpatient days increased by 3.4% or 233 days and outpatient visits increased by 0.9% or 463 visits. RDS discharges continue to be negatively impacted by the challenge of recruiting and retaining physicians in these small markets and the continued trend of more services being performed in an outpatient setting versus an inpatient setting.

Other operating revenue decreased by ($5.5) million during the quarter ended December 31, 2016 compared to the fourth quarter of 2015 due to a decline in meaningful use dollars received related to implementation of the electronic medical record.

For the three month period ended December 31, 2016 total operating expenses increased $66.1 million to $795.5 million from $729.4 million in 2015. $31.5 million or 47.7% of the increase in total operating expenses is driven by the increase in Medical claims expense directly related to increased Centennial Care membership and increased utilization overall in the health plan. Salary expenses increased $14.6 million or 6.6% related mid year salary increases throughout the system, higher staffing levels in the hospitals and clinics in line with higher volumes in the Central Delivery System and higher use of agency nursing. Purchased services increased by $10.3 million or 7.5% due to increased state premium and Affordable Care Act (ACA) taxes in the health plan. Supplies expense increased $7.3 million or 11.0% due to higher drug costs. In addition, the specialty pharmacy has experienced increased volumes with a trend of dispensing more oncological oral drugs in place of other therapies. Professional fees increased by $0.2 million or 1.7% from increased usage of locum tenens and increased volumes in the current quarter compared to the same period in 2015. Depreciation and amortization expense increased by $1.5 million or 7.9% due to a smaller reduction to true up depreciation for assets not yet put in use compared to the prior year. Interest expense increased by $0.6 million in the quarter ended December 31, 2016 compared to the same quarter in 2015 due primarily to a recent increase in short-term interest rates related to our variable rate demand bonds.

Years Ended December 31, 2016 and 2015

For the year ended December, 2016 total operating income decreased by ($50.6) million to $74.7 million (2.4% operating margin) from $125.3 million (4.3% operating margin) in 2015.

Total operating revenue for the year ended December 31, 2016 increased by $241.1 million to $3.14 billion from $2.90 billion in 2015. This increase is due primarily to a $227.4 million or 12.5% increase in net premium revenue related primarily to Centennial Care. Net patient service revenue increased $18.0 million or 1.8% during the year to $1.02 billion compared to $1.00 billion in 2015 driven by higher outpatient volumes and lower provision for bad debts.

During the year ended December 31, 2016, total inpatient discharges for PDS increased by 3.6% or 1,882 discharges compared to the year ended December 31, 2015 while total inpatient days increased by 4.4% or 10,106 days. Total outpatient visits increased by 4.3% or 27,144 visits. Outpatient volumes throughout the system continue to benefit from the shifting of services to an outpatient setting from an inpatient setting as well as an increase in the number of clinics and providers.

Inpatient discharges for the Obligated Group increased 4.3% or 2,141 discharges during 2016 compared to 2015. Inpatient days increased during the year by 4.7% or 10,550 days. Outpatient visits increased by 4.1% or 24,140 visits.

Inpatient discharges within CDS increased during the year ended December 31, 2016 by 6.4% or 2,675 discharges. Inpatient Days were up from prior year by 5.6% or 11,391 days. Total Outpatient Visits in CDS increased by 4.6% or 19,919 visits.

Inpatient discharges in RDS decreased during the year ended December 31, 2016 compared to 2015 by (7.6%) or (793) discharges, while total inpatient days also decreased by (4.3%) or (1,285) days. Inpatient volumes in the regional hospitals continue to be impacted by provider vacancies. Outpatient visits increased by 3.6% or 7,225 visits during 2016 consistent with the overall system trend.

Other operating revenue decreased during 2016 compared to 2015 by ($4.2) million or (5.8%) related to an overall reduction in the amount of meaningful use dollars received related to the implementation of the electronic medical record.

The payer mix for PHS experienced a (0.9%) decrease in Commercial net revenue during 2016 compared to 2015. Medicaid increased 0.3% and Medicare increased 0.9%. The increase in Medicaid over the last three years is due to the coverage expansion built into the Centennial Care program.

For the year ended December 31, 2016 total operating expenses increased $291.7 million to $3.06 billion from $2.77 billion in 2015. Medical claims increased $174.5 million or 16.7%, and 59.8% of the total increase in operating expenses for the year, due primarily to the expanded Medicaid program under Centennial Care. Salary expenses increased $43.7 million or 5.0% compared to 2015 due higher staffing levels in the hospitals and clinics in line with higher volumes in the Central Delivery System, higher use of agency nursing, and mid year salary increases. Purchased services increased $23.5 million or 5.2% and was driven in large part by an increase in state premium and ACA taxes in the health plan. Supplies expense increased $40.5 million or 16.8% due to higher drug costs. In addition, the specialty pharmacy has experienced increased volumes with a trend of dispensing more oncological oral drugs in place of other. Professional fees increased by $5.0 million or 13.3% due to increased usage of locum tenens and higher volumes. Depreciation expense increased by $1.3 million or 1.4% over 2015 driven by shorter lived technology assets. Interest expense increased during 2016 by $3.1 million or 12.4% due primarily to rising short-term rates related to our variable rate demand bonds and the net increase in long-term debt that resulted from the issuance of the 2015A bonds in May, 2015.

Investment Income

The Investment Subcommittee of the PHS Board works with an investment consultant to review asset class allocations, select and monitor various professional investment managers and to oversee Presbyterian's investment portfolios in accordance with the investment policy and guidelines.

The unrestricted cash and investments of the Obligated Group at December 31, 2016 consisted of the following:

(In Millions)

Asset Class	Target PHS	PHS	Target Foundation	Foundation	Total
Large Cap Equity	16%	$ 245.1	15.3%	$ 14.7	$ 259.8
Small Cap Equity	4%	63.1	1.2%	2.9	66.0
International and Emerging Markets	20%	323.9	18.5%	18.1	342.0
Alternatives	20%	283.7	37.5%	22.9	306.6
Fixed income	35%	496.4	27.5%	23.2	519.6
Cash	5%	115.9	- %	3.7	119.6
Total	100%	1,528.1	100%	85.5	1,613.6
Less Restricted Net Assets		-		(38.3)	(38.3)
Total Unrestricted Obligated Group		$ 1,528.1		$ 47.2	$ 1,575.3

Total unrestricted investments for the Obligated Group include the PHS Corporate portfolio and the PHS Foundation portfolio. At December 31, 2016 the unrestricted Obligated Group portfolio totaled $1.57 billion.

Realized investment gains for PHS totaled $39.3 million and $30.5 million for the three month periods ended December 31, 2016 and 2015, respectively, and $74.1 million and $71.6 million for the years ended December 31, 2016 and 2015, respectively. The combined investment income and changes in unrealized gains on investments for 2016 was a gain of $127.2 million compared to a loss of ($34.5) million for 2015. The investment returns for the PHS Corporate and Foundation portfolios were 0.1% and 0.5%, respectively, for the quarter ended December 31, 2016, and 7.4% and 7.9%, respectively, for the year ended December 31, 2016.

Liquidity and Capital Resources

On a combined basis, unrestricted cash and investments of PHS totaled $2.1 billion as of December 31, 2016, an increase of $163 million from December 31, 2015.

On May 19, 2015 PHS issued the 2015 Series A Revenue Bonds with a par value of $237.2 million. Proceeds of the bonds were used to refund and defease the majority of the 2008A Revenue Bonds and provide approximately $118 million to fund the construction or improvement of various healthcare facilities throughout the PHS system. Prior to the issuance of the 2015A bonds PHS used $18 million of existing cash to fund an escrow account to refund and defease the 2008A Revenue Bonds not refunded and defeased by the 2015A bonds. The pre-refunding of the 2008A bonds resulted in a loss on early redemption of $24.1 million which is included in non-operating income (loss) on the statement of operations. The long term savings of the lower effective interest rate of the 2015A bonds produced a net present value of $10 million which will be realized through a lower effective interest rate going forward. At December 31, 2016, the unspent funds remaining in the restricted project account totaled $23.8 million.

Cash provided by operating activities totaled $103.9 million for the year ended December 31, 2016 compared to $134.7 million for 2015. Net cash used in investing activities was $68.8 million, including capital expenditures of $89.6 million, during 2016 compared to a net used of $184.5 million, including capital expenditures of $133.9 million, for 2015. Total capital expenditures for fiscal 2017 are expected to approximate $200 million and will be financed primarily from the remaining proceeds from the 2015A Bonds and $165 million of new money bonds anticipated to be issued in the second quarter of 2017. Capital expenditures in 2017 will include the construction of a new hospital in Santa Fe, New Mexico and the expansion of the corporate administrative facility.

Days cash on hand for PHS and the Obligated Group was 264 days and 349 days, respectively, as of December 31, 2016, compared to 269 days and 338 days, respectively, at December 31, 2015.

Obligated Group Financial Indicators

	Year Ended December 31				
	2012	2013	2014	2015	2016
Operating Margin	1.3%	2.7%	2.8%	3.5%	2.3%
Excess margin	9.3%	11.3%	6.3%	(0.4%)	7.0%
Adjusted excess margin	5.0%	7.3%	9.0%	6.6%	5.3%
Unrestricted days cash on hand	307	351	359	338	349
Debt to cash flow	4.0x	3.1x	2.6x	3.5x	3.7x
Maximum Annual Debt Service Coverage	4.3x	5.5x	6.6x	3.0x	5.0x
Long-term debt to total capitalization	41%	31%	30%	35%	32%