

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Net Position (Unaudited)
June 30, 2017 and 2016
(Amounts in Thousands)

	<u>2017</u>	<u>2016</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 28,049	\$ 52,930
Short-term investments	154,768	155,191
Patient accounts receivable, net of allowance for uncollectibles of \$53,276 and \$70,521, respectively	242,734	211,011
Inventories	17,511	15,153
Prepaid expenses and other current assets	47,750	50,680
Assets whose use is limited, current portion	38,023	35,202
Total current assets	<u>528,835</u>	<u>520,167</u>
Assets whose use is limited, less current portion	517,902	433,276
Assets whose use is restricted	39,910	159,135
Capital assets, net	981,161	848,106
Other assets	93,674	89,242
Total assets	<u>2,161,482</u>	<u>2,049,926</u>
Deferred outflows of resources		
Accumulated decrease in fair value of hedging derivatives	49,013	72,224
Deferred loss on debt refunding	376	416
Deferred outflows on pension	88,333	87,457
Total deferred outflows of resources	<u>137,722</u>	<u>160,097</u>
Liabilities		
Current liabilities		
Long-term debt, current portion	17,200	17,034
Capital lease obligations, current portion	271	214
Accounts payable and accrued expenses	110,177	122,330
Accrued salaries and leave payable	62,050	56,677
Estimated third-party payor settlements	109,763	77,000
Total current liabilities	<u>299,461</u>	<u>273,255</u>
Long-term liabilities		
Long-term debt, less current portion	825,222	838,652
Capital lease obligations, less current portion	1,852	756
Other liabilities	91,150	128,567
Total long-term liabilities	<u>918,224</u>	<u>967,975</u>
Total liabilities	<u>1,217,685</u>	<u>1,241,230</u>
Deferred inflows of resources		
Deferred gain on debt refunding	2,732	2,936
Deferred inflows on pension	26,632	31,419
Total deferred inflows of resources	<u>29,364</u>	<u>34,355</u>
Net position		
Net investment in capital assets	136,616	99,370
Restricted		
Nonexpendable	253	97
Expendable	9,038	9,959
Unrestricted	906,248	825,012
Total net position	<u>\$ 1,052,155</u>	<u>\$ 934,438</u>

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Revenues, Expenses and Changes in Net Position (Unaudited)
For the Years Ended June 30, 2017 and 2016
(Amounts in Thousands)

	<u>2017</u>	<u>2016</u>
Operating revenues		
Net patient service revenue, net of provision for bad debts of \$84,644 and \$135,847, respectively	\$ 1,404,889	\$ 1,337,704
Other operating revenue	19,702	20,452
Total operating revenues	<u>1,424,591</u>	<u>1,358,156</u>
Operating expenses		
Salaries and benefits	614,001	587,434
Supplies and services	599,540	574,379
Depreciation and amortization	55,795	57,357
Total operating expenses	<u>1,269,336</u>	<u>1,219,170</u>
Operating income	<u>155,255</u>	<u>138,986</u>
Nonoperating revenues (expenses)		
State appropriations	7,050	7,050
Interest expense	(21,728)	(22,966)
Net Investment income, including change in fair value	36,758	23,006
Gain (loss) on disposal of capital assets, net	363	(138)
Other nonoperating revenues (expenses), net	912	(3,804)
Total nonoperating revenues, net	<u>23,355</u>	<u>3,148</u>
Excess of revenues over expenses before transfers, capital contributions, and other changes in net position	178,610	142,134
Transfers and expenditures in support of the University of Florida and its medical programs	(66,328)	(63,416)
Other transfers	-	(17,688)
Capital contributions	6,200	654
Other changes in net position	(765)	2,313
Increase in net position	<u>117,717</u>	<u>63,997</u>
Net position		
Beginning of year	934,438	870,441
End of year	<u>\$ 1,052,155</u>	<u>\$ 934,438</u>

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Cash Flows (Unaudited)
For the Years Ended June 30, 2017 and 2016
(Amounts in Thousands)

	2017	2016
Cash flows from operating activities		
Cash received from patients and third-party payors	\$ 1,406,467	\$ 1,324,154
Other receipts from operations	21,306	16,727
Salaries and benefits paid to employees	(617,868)	(584,665)
Payments to suppliers and vendors	(614,843)	(551,526)
Net cash provided by operating activities	<u>195,062</u>	<u>204,690</u>
Cash flows from noncapital financing activities		
Payments received on notes receivable	1,674	3,049
Payments in support of the University of Florida and its medical programs	(66,328)	(63,416)
Donations and pledge receipts	10,388	13,059
Other noncapital financing activities	(8,871)	(11,765)
Net cash used in noncapital financing activities	<u>(63,137)</u>	<u>(59,073)</u>
Cash flows from capital and related financing activities		
Purchase of capital assets	(172,354)	(137,813)
Proceeds from sale of capital assets	2	51
Proceeds from issuance of long-term debt	-	46,600
Advance refunding of debt	-	(52,085)
Payment of debt issuance costs	-	(218)
Payments of long-term debt	(16,316)	(22,747)
Interest payments	(32,831)	(33,263)
Receipt (posting) of collateral on interest rate swaps, net	8,584	(13,029)
Capital contributions	6,200	654
Reimbursement from trustee-held project fund	108,828	91,901
Net cash used in capital and related financing activities	<u>(97,887)</u>	<u>(119,949)</u>
Cash flows from investing activities		
Investment income received	10,983	11,444
Interest in joint venture, net of dividends received	(10,068)	-
Purchase of short-term investments and assets whose use is limited	(232,000)	(162,000)
Purchase of assets whose use is restricted	(41,448)	(58,938)
Sale of short-term investments and assets whose use is limited	157,940	49,785
Sale of assets whose use is restricted	51,845	144,123
Other investing activity	3,829	9,191
Net cash used in investing activities	<u>(58,919)</u>	<u>(6,395)</u>
Net (decrease) increase in cash and cash equivalents	<u>(24,881)</u>	<u>19,273</u>
Cash and cash equivalents		
Beginning of year	52,930	33,657
End of year	<u>\$ 28,049</u>	<u>\$ 52,930</u>

Certain amounts in the consolidated basic statement of cash flows (unaudited) for the year ended June 30, 2016 have been reclassified to conform with the presentation used in the unaudited consolidated basic statement of cash flows for the year ended June 30, 2017. The reclassifications increased net cash used by noncapital financing activities by \$11,765 and decreased cash flows used in investing activities by \$11,765 for the year ended June 30, 2016. The reclassifications did not have an impact on net increase in cash and cash equivalents for the year ended June 30, 2016 or cash and cash equivalents as of June 30, 2016.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Cash Flows (Unaudited)
For the Years Ended June 30, 2017 and 2016
(Amounts in Thousands)

	<u>2017</u>	<u>2016</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 155,255	\$ 138,986
Adjustments to operating income to net cash provided by operating activities		
Depreciation and amortization	55,795	57,357
Provision for bad debts	84,644	135,847
Changes in:		
Patient accounts receivable	(115,830)	(160,081)
Inventories	(2,358)	(937)
Prepaid expenses and other current assets	9,626	16,313
Other assets	(6,529)	3,008
Accounts payable and accrued expenses	(15,170)	30,008
Accrued salaries and leave payable	5,372	5,226
Estimated third-party payor settlements	32,763	7,302
Other liabilities	(8,506)	(28,339)
Total adjustments	39,807	65,704
Net cash provided by operating activities	<u>\$ 195,062</u>	<u>\$ 204,690</u>
Supplemental noncash investing, capital and financing activities		
Capital assets financed through capital lease and installment debt	\$ 4,062	\$ -

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Net Position (Unaudited)
June 30, 2017
(Amounts in Thousands)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group	UF Health Shands HomeCare
Assets						
Current assets						
Cash and cash equivalents	\$ 16,485	\$ 1	\$ -	\$ -	\$ 16,486	\$ -
Short-term investments	154,723	-	-	-	154,723	-
Patient accounts receivable, net	232,303	3,938	3,471	-	239,712	2,101
Inventories	17,511	-	-	-	17,511	-
Prepaid expenses and other current assets	45,704	565	751	(663)	46,357	285
Assets whose use is limited, current portion	38,023	-	-	-	38,023	-
Total current assets	504,749	4,504	4,222	(663)	512,812	2,386
Assets whose use is limited, less current portion	517,902	-	-	-	517,902	-
Assets whose use is restricted	39,910	-	-	-	39,910	-
Capital assets, net	963,233	8,944	1,438	-	973,615	1,520
Due from affiliates, net	5,711	-	-	-	5,711	-
Other assets	62,874	959	1,255	-	65,088	-
Total assets	2,094,379	14,407	6,915	(663)	2,115,039	3,906
Deferred outflows of resources						
Accumulated decrease in fair value of hedging derivatives	49,013	-	-	-	49,013	-
Deferred loss on debt refunding	376	-	-	-	376	-
Deferred outflows on pension	88,333	-	-	-	88,333	-
Total deferred outflows of resources	137,722	-	-	-	137,722	-
Liabilities						
Current liabilities						
Long-term debt, current portion	17,200	-	-	-	17,200	-
Capital lease obligations, current portion	163	-	-	-	163	108
Accounts payable and accrued expenses	103,207	501	309	-	104,017	340
Accrued salaries and leave payable	61,628	319	38	-	61,985	18
Estimated third-party payor settlements	109,963	128	-	(663)	109,428	-
Total current liabilities	292,161	948	347	(663)	292,793	466
Long-term liabilities						
Long-term debt, less current portion	825,222	-	-	-	825,222	-
Capital lease obligations, less current portion	586	-	-	-	586	1,266
Due to affiliates, net	-	-	-	-	-	-
Other liabilities	91,069	-	-	-	91,069	-
Total long-term liabilities	916,877	-	-	-	916,878	1,266
Total liabilities	1,209,038	948	347	(663)	1,209,671	1,732
Deferred inflows of resources						
Deferred gain on debt refunding	2,732	-	-	-	2,732	-
Deferred inflows on pension	26,632	-	-	-	26,632	-
Total deferred inflows of resources	29,364	-	-	-	29,364	-
Net position						
Net investment in capital assets	120,210	8,944	1,438	-	130,592	1,520
Restricted						
Nonexpendable	253	-	-	-	253	-
Expendable	8,812	-	-	-	8,812	-
Unrestricted	864,424	4,515	5,130	-	874,069	654
Total net position	\$ 993,699	\$ 13,459	\$ 6,568	\$ -	\$ 1,013,726	\$ 2,174

(1) "Other" includes the amounts for UF Health Florida Recovery Center, ElderCare of Alachua County, Inc., Southeastern HealthCare Foundation, Inc., and Joint Ventures.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Net Position (Unaudited)
June 30, 2017
(Amounts in Thousands)

	Property Management	Eliminations	Total Obligated Group	Other (1)	Eliminations	Consolidated Total
Assets						
Current assets						
Cash and cash equivalents	\$ -	\$ -	\$ 16,486	\$ 11,563	\$ -	\$ 28,049
Short-term investments	-	-	154,723	45	-	154,768
Patient accounts receivable, net	-	-	241,813	921	-	242,734
Inventories	-	-	17,511	-	-	17,511
Prepaid expenses and other current assets	9	-	46,651	1,099	-	47,750
Assets whose use is limited, current portion	-	-	38,023	-	-	38,023
Total current assets	9	-	515,207	13,628	-	528,835
Assets whose use is limited, less current portion	-	-	517,902	-	-	517,902
Assets whose use is restricted	-	-	39,910	-	-	39,910
Capital assets, net	4,504	-	979,639	1,522	-	981,161
Due from affiliates, net	-	(23)	5,688	-	(5,688)	-
Other assets	-	-	65,088	28,586	-	93,674
Total assets	4,513	(23)	2,123,434	43,736	(5,688)	2,161,482
Deferred outflows of resources						
Accumulated decrease in fair value of hedging derivatives	-	-	49,013	-	-	49,013
Deferred loss on debt refunding	-	-	376	-	-	376
Deferred outflows on pension	-	-	88,333	-	-	88,333
Total deferred outflows of resources	-	-	137,722	-	-	137,722
Liabilities						
Current liabilities						
Long-term debt, current portion	-	-	17,200	-	-	17,200
Capital lease obligations, current portion	-	-	271	-	-	271
Accounts payable and accrued expenses	33	-	104,390	5,787	-	110,177
Accrued salaries and leave payable	-	-	62,003	47	-	62,050
Estimated third-party payor settlements	-	-	109,428	335	-	109,763
Total current liabilities	33	-	293,292	6,169	-	299,461
Long-term liabilities						
Long-term debt, less current portion	-	-	825,222	-	-	825,222
Capital lease obligations, less current portion	-	-	1,852	-	-	1,852
Due to affiliates, net	23	(23)	-	5,688	(5,688)	-
Other liabilities	-	-	91,069	81	-	91,150
Total long-term liabilities	23	(23)	918,143	5,769	(5,688)	918,224
Total liabilities	56	(23)	1,211,435	11,938	(5,688)	1,217,685
Deferred inflows of resources						
Deferred gain on debt refunding	-	-	2,732	-	-	2,732
Deferred inflows on pension	-	-	26,632	-	-	26,632
Total deferred inflows of resources	-	-	29,364	-	-	29,364
Net position						
Net investment in capital assets	4,504	-	136,616	-	-	136,616
Restricted						
Nonexpendable	-	-	253	-	-	253
Expendable	-	-	8,812	226	-	9,038
Unrestricted	(47)	-	874,676	31,572	-	906,248
Total net position	\$ 4,457	\$ -	\$ 1,020,357	\$ 31,798	\$ -	\$ 1,052,155

(1) "Other" includes the amounts for UF Health Florida Recovery Center, ElderCare of Alachua County, Inc., Southeastern HealthCare Foundation, Inc., and Joint Ventures.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Revenues, Expenses and
Changes in Net Position (Unaudited)
For the Year Ended June 30, 2017
(Amounts in Thousands)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group
Operating revenues					
Net patient service revenue, net of provision for bad debts	\$ 1,347,430	\$ 21,131	\$ 21,542	\$ (405)	\$ 1,389,698
Other operating revenue	15,189	35	-	-	15,224
Total operating revenues	1,362,619	21,166	21,542	(405)	1,404,922
Operating expenses					
Salaries and benefits	574,622	14,020	13,177	1,478	603,297
Supplies and services	587,310	4,576	4,163	(1,883)	594,166
Depreciation and amortization	54,557	756	176	-	55,489
Total operating expenses	1,216,489	19,352	17,516	(405)	1,252,952
Operating income	146,130	1,814	4,026	-	151,970
Nonoperating revenues (expenses)					
State appropriations	7,050	-	-	-	7,050
Interest expense	(21,683)	-	-	-	(21,683)
Net investment income, including change in fair value	36,702	-	-	-	36,702
Gain on disposal of capital assets, net	363	-	-	-	363
Other nonoperating revenues (expenses), net	1,774	296	-	-	2,070
Total nonoperating revenues (expenses), net	24,206	296	-	-	24,502
Excess of revenues over expenses before transfers, capital contributions and other changes in net position	170,336	2,110	4,026	-	176,472
Transfers and expenditures in support of the University of Florida and its medical programs	(63,219)	(998)	-	-	(64,217)
Other transfers	-	-	-	-	-
Transfer of net assets in association with the support of other operations and divisions of Shands	579	(378)	(2,231)	-	(2,030)
Capital contributions	6,200	-	-	-	6,200
Other changes in net position	(749)	-	-	-	(749)
Increase (decrease) in net position	113,147	734	1,795	-	115,676
Net position					
Beginning of year	880,552	12,725	4,773	-	898,050
End of year	\$ 993,699	\$ 13,459	\$ 6,568	\$ -	\$ 1,013,726

(1) "Other" includes the amounts for UF Health Florida Recovery Center, ElderCare of Alachua County, Inc., Southeastern HealthCare Foundation, Inc., and Joint Ventures.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Revenues, Expenses and
Changes in Net Position (Unaudited)
For the Year Ended June 30, 2017
(Amounts in Thousands)

	UF Health Shands HomeCare	Property Management	Total Obligated Group	Other (1)	Eliminations	Consolidated Total
Operating revenues						
Net patient service revenue, net of provision for bad debts	\$ 8,356	\$ -	\$ 1,398,054	\$ 6,835	\$ -	\$ 1,404,889
Other operating revenue	22	722	15,968	3,989	(255)	19,702
Total operating revenues	8,378	722	1,414,022	10,824	(255)	1,424,591
Operating expenses						
Salaries and benefits	6,363	-	609,660	4,341	-	614,001
Supplies and services	1,429	404	595,999	4,091	(550)	599,540
Depreciation and amortization	147	159	55,795	-	-	55,795
Total operating expenses	7,939	563	1,261,454	8,432	(550)	1,269,336
Operating income	439	159	152,568	2,392	295	155,255
Nonoperating revenues (expenses)						
State appropriations	-	-	7,050	-	-	7,050
Interest expense	(45)	-	(21,728)	-	-	(21,728)
Net investment income, including change in fair value	-	-	36,702	56	-	36,758
Gain on disposal of capital assets, net	-	-	363	-	-	363
Other nonoperating revenues (expenses), net	-	-	2,070	(863)	(295)	912
Total nonoperating revenues (expenses), net	(45)	-	24,457	(807)	(295)	23,355
Excess of revenues over expenses before transfers, capital contributions and other changes in net position	394	159	177,025	1,585	-	178,610
Transfers and expenditures in support of the University of Florida and its medical programs	-	-	(64,217)	(2,111)	-	(66,328)
Other transfers	-	-	-	-	-	-
Transfer of net assets in association with the support of other operations and divisions of Shands	200	(290)	(2,120)	2,120	-	-
Capital contributions	-	-	6,200	-	-	6,200
Other changes in net position	-	-	(749)	(16)	-	(765)
Increase (decrease) in net position	594	(131)	116,139	1,578	-	117,717
Net position						
Beginning of year	1,580	4,588	904,218	30,220	-	934,438
End of year	\$ 2,174	\$ 4,457	\$ 1,020,357	\$ 31,798	\$ -	\$ 1,052,155

(1) "Other" includes the amounts for UF Health Florida Recovery Center, ElderCare of Alachua County, Inc., Southeastern HealthCare Foundation, Inc., and Joint Ventures.

Shands Teaching Hospital and Clinics, Inc. Obligated Group
Summary of Financial and Operational Indicators
For the Years Ended June 30, 2017 and 2016

	2017	2016
Utilization Statistics		
Licensed beds	1,016	996
Beds in service	973	969
Admissions-Routine (excludes newborns)	47,408	47,176
Admissions-Observation Cases	7,895	7,915
Admissions-Combined	55,303	55,091
Patient days-total (excludes newborns)	303,638	308,642
Average length of stay (days)	5.5	5.6
Percentage occupancy (beds in service)	85.5%	87.0%
Emergency room and trauma center visits	125,350	116,248
Outpatient visits	866,517	845,032
Calendar Days	365	366
Payor Mix - Gross Revenues		
Medicare	37.3%	38.3%
Medicaid	21.9%	21.4%
Blue Cross	18.5%	16.9%
Commercial	2.0%	2.1%
Managed Care	9.7%	10.8%
Self-pay	5.0%	4.6%
Other	5.6%	5.9%
Total	100.0%	100.0%
Other		
Medicare case mix index for reporting period	2.016	2.115

Shands Teaching Hospital and Clinics, Inc. Obligated Group
Debt Covenant Calculations Comparison to Minimum Requirements
As of and for the Year Ended June 30, 2017

	Results	Requirements				
		Master	2008A Bonds	2007A&B Bonds		
		Trust	2008C Bonds	2012A&B Bonds	2013A Notes	
		Indenture	2010A Bonds	PNC Note	2014A&B Bonds	2016A Bonds
Debt Service Coverage Ratio	4.5	=> 1.1	=> 1.4	=> 1.4	N/A	=> 1.2
Total Debt to Capitalization Ratio	44.9%	N/A	N/A	=< 65%	N/A	=< 65%
Days Cash on Hand	205.4	N/A	N/A	=> 60	N/A	=> 60

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

Introduction

This section of the Shands Teaching Hospital and Clinics, Inc. and Subsidiaries' ("Shands") annual financial report presents Shands' analysis of its financial performance as of and for the year ended June 30, 2017 with comparative information as of and for the years ended June 30, 2016 and 2015. This discussion has been prepared by management and should be read in conjunction with the consolidated basic financial statements and related note disclosures.

Organization

Shands is an affiliate of the University of Florida ("UF") where by statute the President of UF has the right to appoint and remove members of the Shands Board of Directors. Shands controls or owns various affiliated entities that operate facilities and provide services that are part of Shands.

Shands and certain of its affiliated entities, along with the UF Health Science Center, operate under d/b/a's beginning with "UF Health." The following identifies the significant component operating units and affiliates of Shands and their respective primary operations:

UF Health Shands Hospital is a major tertiary care teaching institution licensed to operate an 895-bed acute care hospital, which provides clinical settings for medical education and training programs at UF.

UF Health Shands Psychiatric Hospital is a psychiatric and substance abuse facility licensed to operate 81 beds, of which 63 are psychiatric and 18 are substance abuse.

UF Health Shands Rehab Hospital is a 40-bed rehabilitation hospital located on the same campus as UF Health Shands Psychiatric Hospital.

UF Health Shands HomeCare is a hospital-based home care agency providing home care services to residents of north central Florida.

Shands Recovery, LLC (d/b/a "UF Health Florida Recovery Center") provides outpatient and residential treatment for alcohol and drug abuse, with on-site leased housing for certain programs.

Property Management leases properties in Gainesville, Florida.

ElderCare of Alachua County, Inc. provides social and health care related services to the elderly in Alachua County.

Southeastern HealthCare Foundation, Inc. provides charitable aid to UF and to Shands and owns and leases various rental properties in Florida.

Joint Ventures: Shands has a 40% minority ownership interest in **Lake Shore HMA, LLC, Starke HMA, LLC,** and **Live Oak HMA, LLC** which own or lease three rural community hospitals (Shands Lake Shore located in Lake City, Florida; Shands Starke located in Starke, Florida; and Shands Live Oak located in Live Oak, Florida). Community Health Systems, Inc. ("CHS") is the majority partner and manages the operations of the three facilities. Shands has a 5% minority interest in **Munroe HMA Holdings, LLC (d/b/a "Munroe Regional Medical Center")** which owns a regional medical center located in Ocala, Florida. CHS manages the operations of the facility and is the majority partner.

Shands has an interest in Shands/Solantic Joint Venture, LLC (**d/b/a "CareSpot"**) which owns three walk-in urgent care centers located in Gainesville, Florida. CareSpot manages the operations of all

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

facilities. In August 2016, Shands sold 0.1% of its ownership interest in CareSpot to Solantic of Orlando, LLC, which results in Shands having a 49.9% minority ownership interest.

Shands and the University of Florida Development Corporation ("UFDC") are members in **Innovation Square, LLC ("Innovation Square")**. Situated between the UF campus and downtown Gainesville, Innovation Square is a planned mixed-use research neighborhood that advances the national and global profile of UF with Shands and the local biotech industry. Shands' financial interest results from assets transferred to Innovation Square, net of amounts received from UFDC representing their financial interest.

In July 2016, Shands acquired a 49% minority ownership interest in **Select Specialty Hospital – Gainesville, LLC ("SSH")** from Select Specialty Hospitals, Inc. ("Select"), an affiliate of Select Medical Corporation ("SMC"). SSH owns and operates a 44 bed long-term acute care hospital ("LTACH") located in Gainesville, Florida. SSH leases the building where the LTACH is located from an affiliate of SSH. Select Unit Management, Inc., a wholly owned subsidiary of SMC, provides management services to SSH.

In December 2016, **UF Health South Central, LLC ("South Central")**, a single member entity owned by Shands, acquired property in Marion County, Florida, consisting of two medical office buildings, two vacant lots, and certain medical equipment. In January 2017, South Central commenced business operations at the two medical office buildings. Also, on March 15, 2017, Florida Clinical Practice Association, Inc., a component unit of UF, acquired a 50% membership interest in South Central.

Required Financial Statements

The required statements are the consolidated basic statements of net position, the consolidated basic statements of revenues, expenses and changes in net position and the consolidated basic statements of cash flows. These statements offer short and long-term financial information about Shands' activities.

The consolidated basic statements of net position reflect all of Shands' assets, liabilities, deferred inflows and outflows and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). Assets, liabilities and deferred activity are presented in a classified format, which distinguishes between their current and long-term time frame. The difference between the assets plus deferred outflows and liabilities plus deferred inflows is reported as "net position."

The consolidated basic statements of revenues, expenses and changes in net position present the change in net position resulting from revenues earned and expenses incurred. All changes in net position are reported as revenues are earned and expenses are incurred, regardless of the timing of related cash flows.

The consolidated basic statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, financing (capital and non-capital), and investing activities. The purpose of the statements is to reflect the key sources and uses of cash during the reporting period.

Financial Analysis of Shands

Statements of Net Position

The condensed consolidated basic statements of net position present the financial position of Shands as of June 30, 2017, 2016 and 2015 and include all assets, liabilities and deferred inflows and outflows. Net position is one indicator of the current financial condition of Shands. Changes in net position are an

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

indicator of whether the overall financial condition of the organization has improved or worsened over a period of time. They also provide the basis for evaluating the capital structure, as well as assessing the liquidity and financial flexibility of Shands. However, the financial statement user should consider other nonfinancial factors, such as changes in economic conditions, population change, regulations, and government legislation affecting the health care industry, among other factors.

The following table presents Shands' condensed consolidated basic statements of net position as of June 30, 2017, 2016 and 2015:

<i>(in thousands of dollars)</i>	2017	2016	2015
Cash and cash equivalents	\$ 28,049	\$ 52,930	\$ 33,657
Short-term investments	154,768	155,191	150,669
Other current assets	346,018	312,046	288,929
Capital assets, net	981,161	848,106	741,104
Other assets	651,486	681,653	807,227
Total assets	<u>2,161,482</u>	<u>2,049,926</u>	<u>2,021,586</u>
Deferred outflows of resources	<u>137,722</u>	<u>160,097</u>	<u>89,878</u>
Current liabilities	299,461	273,255	231,898
Long-term liabilities	918,224	967,975	919,650
Total liabilities	<u>1,217,685</u>	<u>1,241,230</u>	<u>1,151,548</u>
Deferred inflows of resources	<u>29,364</u>	<u>34,355</u>	<u>89,475</u>
Net position			
Net investment in capital assets	136,616	99,370	60,853
Restricted			
Nonexpendable	253	97	97
Expendable	9,038	9,959	7,646
Unrestricted	906,248	825,012	801,845
Total net position	<u>\$ 1,052,155</u>	<u>\$ 934,438</u>	<u>\$ 870,441</u>

Assets and Deferred Outflows of Resources

During 2017, cash and cash equivalents decreased by \$24.9 million, or 47.0%. Cash provided by operating activities was \$195.1 million. Other significant sources of cash included \$108.8 million from a trustee-held project fund for reimbursement of construction requisitions, \$10.4 million of donations and pledge receipts, and a net receipt of \$8.6 million of additional collateral for certain interest rate swaps. Significant cash uses included payments of \$66.3 million in support of UF and its medical programs, purchases of capital assets of \$172.4 million, principal and interest payments of \$49.1 million on outstanding debt, the transfer of \$50.0 million in excess cash flows into the Strategic Capital Fund (a component of assets whose use is limited), and \$10.1 million for investments in joint venture partnerships (net of dividends received), including the purchase of Shands' interests in SSH and South Central. Short-term investments decreased by \$0.4 million, or 0.3%. During 2016, cash and cash equivalents increased by \$19.3 million, or 57.3%. Cash provided by operating activities was \$204.7 million. In addition, cash increased by \$91.9 million due to reimbursement of construction requisitions from a trustee-held project fund. Cash uses included payments of \$63.4 million in support of UF and its medical programs, purchases of capital assets of \$137.8 million, principal and interest payments of \$56.0 million on

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

outstanding debt, and posting of additional collateral of \$13.0 million for certain interest rate swaps. In addition, the Series 2016A Series Bonds were issued to advance refund the Series 2008D1 Bonds and Series 2008D2 Bonds (see "Advance Refunding" on page 10). Short-term investments increased by \$4.5 million, or 3.0%, as funds generated from operations were invested in anticipation of future working capital needs.

Other current assets, including net patient accounts receivable, inventories, prepaid expenses and other current assets, and assets whose use is limited, current portion increased in 2017 by \$34.0 million, or 10.9%. Patient accounts receivable, net increased by \$31.7 million primarily due to volume growth, increased payment rates for certain payors, and an increase in the average time to collect on patient accounts. Inventories increased by \$2.4 million due to increased surgical and endoscopy inventory. Prepaid expenses and other current assets decreased by \$2.9 million due to a decrease in non-patient receivables, and assets whose use is limited, current portion increased by \$2.8 million. In 2016, other current assets, including net patient accounts receivable, inventories, prepaid expenses and other current assets, and assets whose use is limited, current portion increased by \$23.1 million, or 8.0%. Patient accounts receivable, net increased by \$22.7 million due to a variety of factors including volume growth, increased payment rates driven by higher case mix intensity and lower than expected collections on receivables, which resulted in an increase in receivable days outstanding. Inventory balances increased by \$0.9 million. Prepaid expenses and other current assets decreased by \$0.5 million.

In 2017, Capital assets, net, increased by \$133.1 million, or 15.7% reflecting purchases of \$172.4 million, partially offset by depreciation and amortization expense of \$55.8 million. Capital purchases included \$127.9 million in construction costs for the new hospitals (see "New Hospitals Project" on page 11). Other significant capital activity included assets acquired through installment debt financing of \$4.1 million, increases of \$2.1 million in retainage payable and \$9.9 million in capitalized interest. In 2016, capital assets, net, increased by \$107.0 million, or 14.4% reflecting purchases of \$137.8 million, which included \$104.1 million in construction costs for the new hospitals. Other significant capital activity included increases of \$17.0 million in retainage payable and \$9.8 million in capitalized interest, offset by depreciation and amortization expense of \$57.4 million.

Other assets decreased in 2017 by \$30.2 million, or 4.4%, primarily due to a decrease of \$119.2 million in assets whose use is restricted partially offset by an increase of \$84.6 million in assets whose use is limited, less current portion. The decrease in assets whose use is restricted is primarily associated with \$108.8 million of payments from the trustee-held project fund as reimbursement for certain capital purchases and a \$8.1 million decrease in funds held as collateral on certain interest rate swaps in a liability position. The increase in assets whose use is limited, less current portion is due to a \$87.6 million increase in board designated funds for capital needs and other health programs partially offset by a \$3.0 million decrease in board designated funds for post-retirement benefits resulting from the termination of a Shands' sponsored retiree medical plan, effective December 31, 2016. In 2016, other assets decreased by \$125.6 million, or 15.6%, primarily due to decreases of \$78.7 million in assets whose use is restricted and \$61.0 million in other assets, partially offset by an increase of \$14.3 million in assets whose use is limited, less current portion. The decrease in assets whose use is restricted is primarily due to a decrease of \$89.6 million in the trustee-held project fund and the application of \$4.3 million of debt service reserve funds towards the advance refunding of the Series 2008D1 Bonds and Series 2008D2 Bonds, partially offset by an increase of \$13.0 million in additional collateral requirements on certain interest rate swaps in a liability position. The decrease in other assets is primarily due to a decrease of \$54.2 million in the pension asset associated with the defined benefit ("DB") pension plan and a \$17.7 million reduction in the note receivable due from Shands Jacksonville Medical Center, Inc. ("SJMC") (see "Other Changes in Net Position" on page 7), partially offset by an \$11.6 million increase in fair value for interest rate swaps in an asset position. The increase in assets whose use is limited, less current portion

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

is due to increases in board designated funds for capital needs, post-retirement benefits, and other health programs.

Deferred outflows of resources decreased in 2017 by \$22.4 million, or 14.0%. The decrease is attributable to a \$23.2 million improvement in the fair value (decrease in liability) of the hedged interest rate swaps, partially offset by a \$0.9 million increase in deferred outflows on pension due to the net differences between projected and actual earnings on pension plan investments and the net impact of changes in actuarial assumptions, actuarial experience and plan contribution levels. In 2016, deferred outflows of resources increased by \$70.2 million, or 78.1%, primarily due to an increase of \$45.9 million in deferred outflows on pension along with an increase of \$24.4 million due to a decline in the fair value of the hedged interest rate swaps. The increase in deferred outflows on pension resulted from the net impact of actuarial assumption changes of \$51.1 million (largely due to mortality assumptions) partially offset by actuarial experience of \$3.3 million and a net reduction of \$1.9 million in plan contribution levels.

Liabilities, Deferred Inflows of Resources and Net Position.

Current liabilities increased in 2017 by \$26.2 million, or 9.6%, primarily due to increases of \$32.8 million in estimated third-party payor settlements and \$5.4 million in accrued salaries and leave payable partially offset by a decrease of \$12.2 million in accounts payable and accrued expenses. The increase in estimated third-party payor settlements is primarily due to changes in estimates to prior year settlement amounts based on recent third-party payor cost report audits, resulting in increased liabilities. The increase in accrued salaries and leave payable and the decrease in accounts payable and accrued expenses are due to the timing of the regular payment cycles for employee and vendor payments. In 2016, current liabilities increased by \$41.4 million, or 17.8%, primarily due to increases of \$35.6 million in accounts payable and accrued expenses, \$5.2 million in accrued salaries and leave payable, and \$7.3 million in estimated third-party payor settlements, partially offset by a decrease of \$6.7 million in long-term debt, current portion. The increase in accounts payable and accrued expenses is primarily due to increases in patient volume, the timing of the regular payment cycle, as well as increases in retainage payable and other accrued expenses. The increase in estimated third-party payor settlements is primarily due to changes in estimates to prior year settlement amounts. The decrease in long-term debt, current portion is due to the final maturity of the Series 2010B Bonds in December 2015.

Long-term liabilities decreased in 2017 by \$49.8 million, or 5.1%, due to an improvement of \$23.2 million in the fair value of interest rate swaps in a liability position, the termination of an interest rate swap in a liability position (fair value of \$10.7 million), principal payments on debt of \$16.3 million including both current and long-term portions, and a decrease of \$3.3 million in other post-retirement benefits liability (due to the termination of the retiree medical plan previously mentioned). In 2016, long-term liabilities increased by \$48.3 million, or 5.3%, due to a decline of \$26.3 million in the fair value of interest rate swaps in a liability position and an increase of \$36.0 million in the DB pension plan liability partially offset by principal payments on debt of \$22.7 million including both current and long-term portions.

Deferred inflows of resources decreased in 2017 by \$5.0 million, or 14.5%, primarily due to a decrease of \$4.8 million in deferred inflows on pension due to the net differences between projected and actual earnings on pension plan investments and the net impact of changes in actuarial assumptions and experience. In 2016, deferred inflows of resources decreased by \$55.1 million, or 61.6%, due to a decrease of \$47.3 million in deferred inflows on pension due to the net differences between projected and actual earnings on pension plan investments and a decrease of \$7.8 million in the deferred gain on debt refunding primarily due to the advance refunding of the Series 2008D1 Bonds and Series 2008D2 Bonds.

Total net position increased in 2017 by \$117.7 million, or 12.6%, due to an excess margin of \$178.6 million and capital contributions of \$6.2 million partially offset by transfers and expenditures in support of UF and its medical programs of \$66.3 million. In 2016, total net position increased by \$64.0 million, or

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

7.4%, due to an excess margin of \$142.1 million, capital contributions of \$0.7 million, and other changes in net position of \$2.3 million, partially offset by transfers and expenditures in support of UF and its medical programs of \$63.4 million and other transfers of \$17.7 million resulting from the reduction in the note receivable due from SJMC (see "Other Changes in Net Position" on page 7).

Statements of Revenues, Expenses and Changes in Net Position

The following table presents Shands' condensed consolidated basic statements of revenues, expenses and changes in net position for the years ended June 30, 2017, 2016 and 2015:

<i>(in thousands of dollars)</i>	2017	2016	2015
Net patient service revenue	\$ 1,404,889	\$ 1,337,704	\$ 1,262,058
Other operating revenue	19,702	20,452	18,844
Total operating revenues	1,424,591	1,358,156	1,280,902
Operating expenses	1,269,336	1,219,170	1,147,499
Operating income	155,255	138,986	133,403
Nonoperating revenues, net	23,355	3,148	933
Excess of revenues over expenses	178,610	142,134	134,336
Other changes in net position			
Transfers and expenditures in support of the University of Florida and its medical programs	(66,328)	(63,416)	(66,533)
Other transfers	-	(17,688)	-
Capital contributions	6,200	654	6,433
Other changes in net position	(765)	2,313	(223)
Increase in net position	117,717	63,997	74,013
Net position			
Beginning of year	934,438	870,441	796,428
End of year	<u>\$ 1,052,155</u>	<u>\$ 934,438</u>	<u>\$ 870,441</u>

Operating Revenues

Total operating revenues increased in 2017 and 2016 by \$66.4 million, or 4.9%, and \$77.3 million, or 6.0%, respectively. The increases in both years were due to increased net patient service revenue.

During 2017, net patient service revenue increased by \$67.2 million, or 5.0%, reflecting increases in admissions of 0.4% and outpatient visits of 3.2%, as well as inflationary payment rate increases across various third-party payors. In 2016, net patient service revenue increased by \$75.6 million, or 6.0%, reflecting increases in admissions of 1.7% and outpatient visits of 7.6%, and an increase of 4.1% in case mix intensity.

Other operating revenue decreased by \$0.8 million, or 3.7% in 2017 and increased by \$1.6 million, or 8.5% in 2016. The changes in both years are primarily due to changes in revenue from organ transplant related services.

Operating Expenses

Operating expenses increased in 2017 by \$50.2 million, or 4.1%. Salaries and benefits increased by \$26.6 million, or 4.5%. Salaries expense increased by \$24.6 million, or 5.5%, reflecting a 3.2% increase

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

in staffing levels due to volume increases, and a 2.5% increase in average wages. Benefits expense increased by \$2.0 million, or 1.4%, primarily due to increases in benefits expense related to staffing level increases (\$5.3 million), partially offset by a one-time expense reduction of \$3.3 million resulting from the termination of the retiree medical plan previously mentioned. Supplies and services increased by \$25.2 million, or 4.4%, resulting from the increased patient volume, including an increase in surgical cases, and inflationary cost increases associated with certain drugs and other medical supplies. Depreciation and amortization expense decreased by \$1.6 million, or 2.7% due to timing of capital purchases and the increase in construction in progress related to the new hospitals. In 2016, operating expenses increased by \$71.7 million, or 6.2%. Salaries and benefits increased by \$42.6 million, or 7.8%. Salaries expense increased by \$15.5 million, or 3.6%, reflecting increases in staffing levels due to volume increases, and average wage increases. Benefits expense increased by \$27.1 million, or 23.6%, primarily due to a \$25.4 million increase in DB pension expense. The increase in expense was largely due to the implementation of new mortality tables and a decrease in the investment return assumption. Supplies and services increased by \$28.3 million, or 5.2%, resulting from increased patient volume and inflationary cost increases associated with certain drugs. Depreciation and amortization expense increased by \$0.8 million, or 1.3%.

Nonoperating Revenues, net

Nonoperating revenues, net increased in 2017 by \$20.2 million and includes income from investments (including changes in the fair value of investments), changes in the fair value of derivative instruments, interest expense and other nonoperating revenues, net. Investment income, net increased by \$23.8 million primarily due to an increase of \$20.3 million in the fair value of investments and an increase of \$4.1 million in realized capital gains on investments. The fair value of investments can vary significantly from year to year due to variability in the financial markets. The change in fair value of derivative instruments, which include non-hedging interest rate swaps, decreased by \$10.1 million. Interest expense decreased by \$1.2 million, largely due to current savings associated with the May 2016 advance refunding of the Series 2008 D1 Bonds and Series 2008 D2 Bonds through the issuance of the Series 2016A Bonds (See "Advance Refunding" on page 10). All other nonoperating revenues, net increased by \$5.3 million. The increase in other nonoperating revenues, net was primarily due to improved joint venture results as the 2016 amount was negatively impacted by a non-recurring adjustment of \$6.6 million. In 2016, nonoperating revenues, net increased by \$2.2 million. Investment income, net increased by \$2.3 million due to increased interest and dividends. The change in fair value of investments increased by \$6.2 million and realized capital gains on investments decreased by \$3.2 million due to variability in the financial markets. The change in fair value of derivative instruments, which include non-hedging interest rate swaps, increased by \$9.5 million. Interest expense decreased by \$2.3 million, largely due to lower bond issuance costs incurred on the Series 2016A Bonds of \$0.2 million compared to the issuance costs incurred on the Series 2014A Bonds and Series 2014B Bonds of \$2.7 million issued in 2015 (see "Issuance of New Debt" on page 10). All other nonoperating revenues, net decreased by \$14.9 million. The decrease in other nonoperating revenues, net was due in part to lower joint venture income due to a non-cash adjustment of \$6.6 million to the investment balance.

Other Changes in Net Position

Transfers and expenditures in support of UF and its medical programs increased in 2017 by \$2.9 million, or 4.6%. Other transfers decreased by \$17.7 million due to the net impact of the transactions with SJMC described below. Capital contributions increased by \$5.5 million reflecting the release of restrictions in 2017 on \$6.2 million of capital donations previously reflected as temporarily restricted donations. Other changes in net position decreased by \$3.1 million primarily due to the release of the temporarily restricted capital donations, partially offset by additional temporarily restricted donations received and increased pledges of \$3.1 million. In 2016, transfers and expenditures in support of UF and its medical programs

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

decreased by \$3.1 million, or 4.7%. Other transfers increased by \$17.7 million due to the net impact of the transactions with SJMC described below. Capital contributions decreased by \$5.8 million reflecting the release of restrictions in 2015 on \$6.0 million of capital donations previously reflected as temporarily restricted. Other changes in net position increased by \$2.5 million primarily due to temporarily restricted donations received as well as increased pledges.

At June 30, 2015, Shands had a note receivable of \$35.8 million due from SJMC. The original note amount was \$42.3 million to be paid in quarterly installments of \$0.8 million including interest of 4.5%, maturing on October 1, 2030. The current portion of the note receivable of \$1.6 million was included within prepaid expenses and other current assets and the long-term portion of the note receivable of \$34.2 million at June 30, 2015 was included within other assets in the accompanying consolidated basic statement of net position. The quarterly payment due July 1, 2015 was made, leaving a net receivable balance of \$35.4 million. On September 30, 2015, after assessment of each organization's financial position, Shands' Board of Directors agreed to reduce the note receivable due from SJMC by \$17.7 million, effective July 1, 2015. Beginning with the payment due on October 1, 2015, quarterly installments of principal and interest were revised to \$0.4 million, with the interest rate and maturity date remaining unchanged. At its meeting on September 28, 2015, the SJMC Board of Directors agreed to the same action.

Previously, SJMC was allowed to pay for its share of electronic medical record system implementation costs over time on an interest-free basis. The amount due from SJMC was \$6.1 million as of June 30, 2015 and was included in prepaid expenses and other current assets in the consolidated basic statement of net position. On September 25, 2015, SJMC offered, and Shands accepted, application of an interest rate of 3% to the monthly amounts outstanding back to July 2011 through June 2015. The impact of this action was to increase prepaid expenses and other current assets and increase net position for interest earned from inception of the arrangement through June 30, 2015 by \$1.6 million.

The net impact of the above actions decreased Shands' net position by \$16.1 million. At June 30, 2017, Shands has a remaining note receivable of \$16.2 million due from SJMC. The current portion of the note receivable of \$0.9 million is included within prepaid expenses and other current assets and the long-term portion of the note receivable of \$15.3 million is included within other assets in the accompanying consolidated basic statement of net position. Amounts related to the electronic medical record system implementation have been paid in full.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

Patient Volumes

The following tables present the associated volumes of each facility on a comparative basis for the years ended 2017, 2016 and 2015.

	2017	2016	Net Change	% Change	2015	Net Change	% Change
Admissions (1)							
UF Health Shands Hospital	50,734	50,672	62	0.1%	50,004	668	1.3%
UF Health Shands Psychiatric Hospital	3,555	3,398	157	4.6%	3,207	191	6.0%
UF Health Shands Rehab Hospital	1,014	1,021	(7)	-0.7%	945	76	8.0%
Total	<u>55,303</u>	<u>55,091</u>	<u>212</u>	<u>0.4%</u>	<u>54,156</u>	<u>935</u>	<u>1.7%</u>
Outpatient Visits (2)							
UF Health Shands Hospital	966,450	933,532	32,918	3.5%	862,991	70,541	8.2%
UF Health Shands Psychiatric Hospital (3)	1,378	1,236	142	11.5%	13,183	(11,947)	-90.6%
UF Health Shands Rehab Hospital	293	1,131	(838)	-74.1%	721	410	56.9%
UF Health Florida Recovery Center (3)	23,746	25,381	(1,635)	-6.4%	16,308	9,073	N/A
Total	<u>991,867</u>	<u>961,280</u>	<u>30,587</u>	<u>3.2%</u>	<u>893,203</u>	<u>68,077</u>	<u>7.6%</u>

(1) Includes inpatient and observation cases

(2) Includes emergency room and trauma visits

(3) For the five month period July 1, 2014 to November 30, 2014, UF Health Shands Psychiatric Hospital reported 11,324 visits for activity that UF Health Florida Recovery Center began reporting effective December 1, 2014.

During 2017, inpatient admissions increased by 0.4% and outpatient visits increased by 3.2%. During 2016, inpatient admissions increased by 1.7% and outpatient visits increased by 7.6%

Statements of Cash Flows

The consolidated basic statements of cash flows provide additional information in regard to Shands' financial results by reporting the major sources and uses of cash. During 2017, cash and cash equivalents decreased by \$24.9 million, or 47.0%. Cash provided by operating activities was \$195.1 million. Other significant sources of cash included \$108.8 million from a trustee-held project fund for reimbursement of construction requisitions, \$10.4 million of donations and pledge receipts, and a net receipt of \$8.6 million of additional collateral for certain interest rate swaps. Significant cash uses included payments of \$66.3 million in support of UF and its medical programs, purchases of capital assets of \$172.4 million, principal and interest payments of \$49.1 million on outstanding debt, the transfer of \$50.0 million in excess cash flows into the Strategic Capital Fund (a component of assets whose use is limited), and \$10.1 million for investments in joint venture partnerships (net of dividends received), including the purchase of Shands' interests in SSH and South Central. Shands also funded the DB pension plan by \$6.0 million in excess of pension expense as management proactively works toward improving the plan's funded status.

During 2016, cash and cash equivalents increased by \$19.3 million, or 57.3%. Cash inflows were primarily a result of cash provided by operating activities of \$204.7 million and reimbursements of \$91.9 million from a trustee-held project fund. Cash outflows include payments of \$63.4 million in support of UF and its medical programs, acquisition of capital assets of \$137.8 million, and principal and interest payments of \$56.0 million on outstanding debt. Shands also funded the DB pension plan by \$2.9 million in excess of pension expense.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

Defined Benefit Pension Plan Funded Status

As of June 30, 2017, the funded status (as measured under ERISA funding rules) was 75.8%, an increase from 65.0% as of June 30, 2016. The increase in the funded status is largely due to improved financial market conditions and rising interest rates. As of June 30, 2016, the funded status was 65.0%, down from 75.1% as of June 30, 2015. To help improve the funded status and lower the cost of plan administration, management offered a lump-sum payment option to terminated vested plan participants. In June 2016, a total of 1,050 plan participants received lump-sum payments totaling \$51.8 million, eliminating \$75.2 million in actuarially determined plan obligations.

Advance Refunding

In May 2016, the Alachua County Health Facilities Authority ("Authority") issued the Series 2016A Bonds in the amount of \$46.6 million on behalf of Shands, to advance refund the Series 2008D1 Bonds of \$21.7 million and Series 2008D2 Bonds of \$22.6 million. The proceeds of the Series 2016A Bonds and debt service reserve funds of \$4.4 million were used to purchase U.S. government securities, to be held in an irrevocable trust to meet the debt service on the refunded bonds through December 1, 2018, and to pay issuance costs of \$0.2 million. In connection with the transaction, a deferred outflow of \$7.0 million was recorded (to be amortized over the life of the new debt) which includes the unamortized bond discount of \$0.5 million related to the refunded debt. The interest rate on the Series 2016A Bonds is fixed at 2.15%. Shands advance refunded the Series 2008D1 Bonds and Series 2008D2 Bonds to reduce its total debt service payments over the next 14.5 years by \$10.9 million and to obtain an economic gain (difference between the present value of the debt service on the new debt and the refunded debt) of \$9.2 million.

Issuance of New Debt

In October 2014, the Authority, on behalf of Shands, issued Series 2014A Bonds (\$250.0 million) and Series 2014B Bonds (\$50.0 million). The bond proceeds of \$322.4 million, which included bond premium of \$22.4 million, were placed in a trustee-held fund; \$2.7 million of the proceeds were used to pay issuance costs, with \$100.0 million used to reimburse Shands for amounts already expended for capital assets. The remaining proceeds in the trustee-held fund are being used exclusively for the construction of the UF Health Heart and Vascular Hospital and the UF Health Neuromedicine Hospital. As of June 30, 2017, there was no remaining balance in the trustee-held fund, reflecting the cumulative net impact of reimbursement requests (\$224.9 million) and interest income (\$5.2 million). The Series 2014A bonds are comprised of \$25.4 million in serial bonds maturing on dates in December 2025 through December 2036 at a fixed rate of 5% and \$224.6 million in term bonds with \$50.0 million at a fixed rate of 4% and \$174.6 million at a fixed rate of 5%, maturing in December 2044. The Series 2014B bonds are comprised of \$50.0 million in serial bonds maturing in December 2034 at a fixed rate of 5%. Both of the series are tax exempt and unenhanced.

Debt Outstanding

As of June 30, 2017, Shands had \$842.4 million in debt outstanding compared to \$855.6 million at June 30, 2016. Long-term debt is comprised of tax exempt bond issues, taxable notes, and installment debt. Shands utilizes interest rate swaps in order to synthetically convert certain variable rate bonds to fixed rate bonds. Including the effect of the interest rate swaps, 86% of Shands' bonds and notes outstanding are fixed while 14% are variable. The Series 1996A Bonds reached final maturity in December 2016. The Series 2007A and Series 2007B Bonds, the Series 2008A Bonds, and the Series 2008C Bonds are variable rate bonds with fixed rate payor interest rate swaps, which synthetically convert them to fixed rate bonds. The Series 2014A Bonds, Series 2014B Bonds, and Series 2016A Bonds are unenhanced fixed rate bonds. The Series 2010A Bonds and the Series 2012A Bonds and Series 2012B Bonds are

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017 and 2016

variable rate bonds. The Series 2013A Taxable Notes and the 2012 Bank Note are taxable fixed rate notes.

As of June 30, 2016, Shands had \$855.6 million in debt outstanding compared to \$876.6 million at June 30, 2015.

New Hospitals Project

Construction is continuing on the UF Health Heart and Vascular Hospital and the UF Health Neuromedicine Hospital. The new hospitals are being constructed on property adjacent to the UF Health Cancer Hospital on the campus of UF Health Shands Hospital in Gainesville, Florida. This project will include a new 9-floor building with 538,000 gross square feet of space. The building is expected to house the following facilities and services:

- 216 private patient beds, including 120 ICU/IMC beds and 96 acute care beds. Located on the patient floors will be a 6 bay inpatient dialysis suite, rehab therapy gym, CT scanner, satellite pharmacy, and a blood gas lab.
- an operating suite with 10 general ORs, 5 hybrid ORs, 1 intraoperative MRI, 5 Cath labs, 16 recovery bays, 38 pre/post-op rooms, blood dispensing station, and a gross pathology lab.
- ambulatory clinic space for Cardiovascular services and Neuromedicine services, a pre-operative clinic, a blood draw station, neurodiagnostic testing and heart and vascular ancillary services.
- a new radiology department with 3 CT scanners (1 located in neuro ICU), 2 MRIs, 2 general radiology rooms, 1 ultrasound room, and 1 fluoroscopy room.

The estimated cost of this project is \$400 million, excluding financing costs and capitalized interest. The project is expected to be completed and placed in service in December 2017. There is no certificate of need approval necessary for this project. Total project costs incurred as of June 30, 2017, excluding financing costs and capitalized interest was \$279.5 million.

Credit Ratings

In March 2017, Standard & Poor's affirmed their previous underlying credit ratings of A- and indicated a "Stable" outlook on all of Shands' rated debt. In November 2016, Moody's Investor Services affirmed their previous underlying credit ratings of A3 and indicated a "Stable" outlook on all of Shands' rated debt.