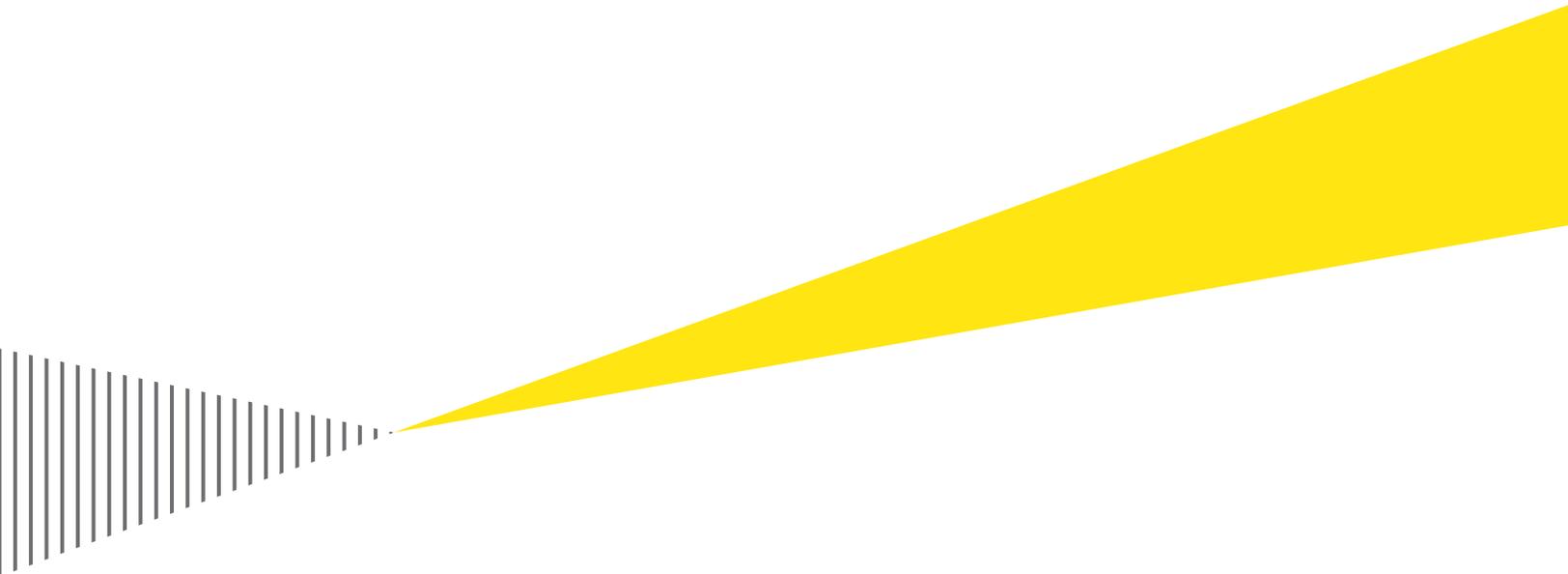


CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Orlando Health, Inc. and Controlled Affiliates
September 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Orlando Health, Inc. and Controlled Affiliates

Consolidated Financial Statements and Supplementary Information

September 30, 2018 and 2017

Contents

Report of Independent Auditors..... 1

Consolidated Financial Statements

Consolidated Balance Sheets 4

Consolidated Statements of Operations and Changes in Net Assets 5

Consolidated Statements of Cash Flows..... 7

Notes to Consolidated Financial Statements..... 8

Supplementary Information

Consolidating Balance Sheet 47

Consolidating Statement of Operations 48

Orlando Health Central, Inc. Consolidating Balance Sheet..... 49

Orlando Health Central, Inc. Consolidating Statement of Operations..... 50



Ernst & Young LLP
Suite 2800
200 South Orange Avenue
Orlando, Florida 32801

Tel: +1 407 872 6600
ey.com

Report of Independent Auditors

The Board of Directors
Orlando Health, Inc. and Controlled Affiliates

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Orlando Health, Inc. and Controlled Affiliates (the System), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audits. We did not audit the financial statements of Lakeland Regional Health Systems, Inc., a wholly-owned subsidiary for the period from October 1, 2017 to September 30, 2018, which statements reflect total unrestricted revenues and other support constituting 20% in 2018 of the related consolidated total. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Lakeland Regional Health Systems, Inc., is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards (GAS)*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

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

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

Opinion

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Orlando Health, Inc. and Controlled Affiliates as of September 30, 2018 and 2017, and the consolidated changes in its net assets and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The System's consolidating balance sheet as of September 30, 2018, and the related consolidating statement of operations for the year then ended and Orlando Health Central, Inc.'s consolidating balance sheet as of September 30, 2018, and the related consolidating statement of operations for the year then ended are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated January 22, 2019 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

Ernst + Young LLP

January 22, 2019

Orlando Health, Inc. and Controlled Affiliates

Consolidated Balance Sheets (In Thousands)

	September 30	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 563,428	\$ 358,845
Assets limited as to use	34,062	38,701
Accounts receivable, less allowances for uncollectible accounts of \$248,797 in 2018 and \$160,404 in 2017	350,082	297,845
Other receivables	64,415	40,033
Inventory	55,135	51,355
Other current assets	41,872	36,690
Total current assets	1,108,994	823,469
Assets limited as to use:		
Debt service and reserve funds held by bond trustee	19,227	43,932
Interest rate swap contract collateral	4,595	14,258
Malpractice self-insurance	13,304	13,428
	37,126	71,618
Less amount required to meet current obligations	(34,062)	(38,701)
	3,064	32,917
Long-term investments – unrestricted	1,635,560	1,185,747
Long-term investments – restricted	117,932	107,651
Investments in related parties	41,867	37,499
Other assets	228,478	268,259
Property and equipment, net	1,465,550	1,301,899
Total assets	\$ 4,601,445	\$ 3,757,441
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 291,121	\$ 256,546
Other current liabilities	174,469	122,718
Current portion of long-term debt	22,152	23,288
Total current liabilities	487,742	402,552
Long-term debt, less current portion	1,300,671	959,404
Accrued malpractice claims	109,728	105,178
Other noncurrent liabilities	108,439	96,935
Total liabilities	2,006,580	1,564,069
Net assets		
Unrestricted:		
Orlando Health, Inc. and Controlled Affiliates	2,469,235	2,018,745
Noncontrolling interests in Controlled Affiliates	(440)	(878)
Total unrestricted	2,468,795	2,017,867
Temporarily restricted	124,625	174,122
Permanently restricted	1,445	1,383
Total net assets	2,594,865	2,193,372
Total liabilities and net assets	\$ 4,601,445	\$ 3,757,441

See accompanying notes.

Orlando Health, Inc. and Controlled Affiliates

Consolidated Statements of Operations and Changes in Net Assets
(In Thousands)

	Year Ended September 30	
	2018	2017
Unrestricted revenues and other support		
Net patient service revenue (net of contractual allowances and discounts)	\$ 4,054,219	\$ 2,687,080
Provision for bad debts	(421,614)	(144,060)
Net patient service revenue less provision for bad debts	3,632,605	2,543,020
Other revenue	174,483	130,085
Net assets released from restrictions	5,872	5,784
Total unrestricted revenues and other support	3,812,960	2,678,889
Expenses		
Salaries and benefits	1,945,932	1,407,648
Supplies and other	1,236,391	846,087
Professional fees	44,682	38,830
Depreciation and amortization	196,298	125,821
Interest	59,694	43,094
Total expenses	3,482,997	2,461,480
Income from operations	329,963	217,409
Nonoperating gains and (losses)		
Investment income	71,956	83,563
Change in fair value of interest rate swap agreements	10,179	15,294
Inherent contribution associated with business combination	526,815	-
Inherent distribution from deconsolidation of business combination	(548,685)	-
Nonoperating gain	2,976	13,576
Loss on early extinguishment of debt	(4,707)	-
Nonoperating gains, net	58,534	112,433
Excess of revenues, other support, and gains over expenses and losses	388,497	329,842
Deficit of revenues, other support, and gains over expenses and losses attributed to noncontrolling interests in Controlled Affiliates	816	1,849
Excess of revenues, other support, and gains over expenses and losses attributed to Orlando Health, Inc. and Controlled Affiliates	389,313	331,691

Orlando Health, Inc. and Controlled Affiliates

Consolidated Statements of Operations and Changes in Net Assets (continued)
(In Thousands)

	Year Ended September 30	
	2018	2017
Unrestricted net assets		
Excess of revenues, other support, and gains over expenses and losses	\$ 388,497	\$ 329,842
Other changes in unrestricted net assets:		
Net assets released from restrictions for property and equipment	60,673	15,449
Other	1,758	(288)
Increase in unrestricted net assets	<u>450,928</u>	<u>345,003</u>
Temporarily restricted net assets		
Contributions	20,827	13,345
Net assets released from restrictions	(66,545)	(21,233)
Inherent contribution associated with business combination	30,346	-
Inherent distribution from deconsolidation of business combination	(35,729)	-
Net realized and unrealized gains on investments	1,698	2,716
Other	(94)	(246)
Decrease in temporarily restricted net assets	<u>(49,497)</u>	<u>(5,418)</u>
Permanently restricted net assets		
Contributions	60	-
Inherent contribution associated with business combination	1,538	-
Inherent distribution from deconsolidation of business combination	(1,538)	-
Other	-	(1,116)
Net realized and unrealized gains on investments	2	2
Increase (decrease) in permanently restricted net assets	<u>62</u>	<u>(1,114)</u>
Increase in net assets	401,493	338,471
Net assets at beginning of year	<u>2,193,372</u>	<u>1,854,901</u>
Net assets at end of year	<u>\$ 2,594,865</u>	<u>\$ 2,193,372</u>

See accompanying notes.

Orlando Health, Inc. and Controlled Affiliates

Consolidated Statements of Cash Flows (In Thousands)

	Year Ended September 30	
	2018	2017
Operating activities		
Increase in net assets	\$ 401,493	\$ 338,471
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	196,298	125,821
Change in value of interest rate swap agreements	(10,179)	(15,294)
Net realized, unrealized, and investment income gains	(69,914)	(50,228)
Loss on early extinguishment of debt	4,707	-
Loss (gain) on sale of assets	1,977	(1,900)
Inherent contribution associated with business combination	(558,699)	-
Inherent distribution from deconsolidation of business combination	585,952	-
Restricted contributions and investment income	(22,587)	(14,701)
Changes in operating assets and liabilities:		
Accounts receivable, net	(65,549)	1,094
Other operating assets	(12,319)	(8,853)
Accounts payable and accrued expenses	43,725	22,086
Other operating liabilities	71,009	28,654
Net cash provided by operating activities	565,914	425,150
Investing activities		
Purchases of property, equipment, and other noncurrent assets	(442,671)	(135,124)
Cash acquired in business combination	24,370	-
Cash disposed of in deconsolidation	(24,042)	-
Proceeds from sale of group purchasing organization	-	11,676
(Increase) decrease in assets limited as to use	(44,253)	11,675
Purchase of trading securities, net of sales	(240,374)	(187,203)
Other investing activities	(7,311)	(29,916)
Net cash used in investing activities	(734,281)	(328,892)
Financing activities		
Proceeds from issuance of long-term debt	475,000	-
Refunding and repayments of long-term debt	(161,093)	(22,826)
Proceeds from debt service reserve fund liquidation	14,509	-
Bond proceeds used for loan costs	(2,090)	-
Grant proceeds received for long-term purposes	24,037	-
Restricted contributions and investment income	22,587	14,701
Net cash provided by (used in) financing activities	372,950	(8,125)
Increase in cash and cash equivalents	204,583	88,133
Cash and cash equivalents at beginning of year	358,845	270,712
Cash and cash equivalents at end of year	\$ 563,428	\$ 358,845
Supplemental disclosures of cash flow information		
Cash paid during the year for interest	\$ 69,588	\$ 45,429
Purchases of property and equipment in accounts payable and accrued expenses	20,116	4,431
Capital lease obligation incurred for property	-	21,000
	\$ 89,704	\$ 70,860

See accompanying notes.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements

September 30, 2018

1. Organization

Orlando Health, Inc. (Orlando Health or the System) and Orlando Health Central, Inc. (Health Central) comprise the Obligated Group. Orlando Health is a tax-exempt organization pursuant to Section 501(c)(3) of the Internal Revenue Code, which controls a diversified health care delivery system headquartered in Orlando, Florida. Orlando Health includes the following hospitals operating in Central Florida: Orlando Regional Medical Center (ORMC), Dr. P. Phillips Hospital, Arnold Palmer Hospital for Children (APH), Winnie Palmer Hospital for Women and Babies (WPH), South Seminole Hospital and Health Central Hospital. APH and WPH are jointly referred to as the Arnold Palmer Medical Center (APMC). Health Central includes a hospital and Health Central Park, a skilled nursing facility. Orlando Health also has a home health services division and eight medical residency programs.

Controlled Affiliates are those entities Orlando Health controls as the sole or majority member, sole shareholder, or through board appointment and approval of all major transactions. Controlled Affiliates operate a variety of health care-related services, including physician practice groups (Orlando Health Physician Group, Inc., Orlando Physician Network, Inc., Orlando Cancer Center, Inc., Physician Associates, LLC (PAL), ORHI, LLC (ORHI), which operates five imaging centers, a fund-raising organization (Orlando Health Foundation, Inc.) and other health care-related services). Healthnet Services, Inc. and its subsidiaries are taxable corporations and are a part of the Controlled Affiliates. The Obligated Group, together with its Controlled Affiliates, is collectively referred to herein as the "System". These consolidated financial statements include the consolidated accounts of Orlando Health, Orlando Health Central, and their Controlled Affiliates. Significant transactions between entities have been eliminated.

Effective October 1, 2017, the System completed a transaction with Lakeland Regional Health Systems, Inc. (LRHS) to create an integrated regional health care system. The System obtained control through a member substitution arrangement whereby the System became the sole corporate member of LRHS without the transfer of consideration. LRHS is a private not-for-profit health system located in Lakeland, Florida. LRHS has a lease and transfer agreement (the Agreement) with Lakeland, Florida (the City), whereby LRHS was formed primarily to manage, control, govern, and lease the existing medical center facility. In consideration of the Agreement, LRHS must pay fixed annual payments through fiscal year ending September 30, 2040. The registered nurses and technical employees of Lakeland Regional Medical Center, Inc. (a subsidiary of LRHS) are represented by the United Food and Commercial Workers Union. The registered nurse and technical employee contracts expire on April 30, 2020. Approximately 36% of Lakeland Regional Medical Center, Inc.'s total employees are represented by union contracts. The registered nurses of Lakeland Regional Medical Center, Inc. represent 78% of the employees under union contract by Lakeland Regional Medical Center, Inc.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

1. Organization (continued)

During 2018, the System recorded the LRHS assets acquired and liabilities assumed at fair value and recognized an inherent contribution associated with business combination of approximately \$558,699,000. Effective September 30, 2018 the System and LRHS agreed to terminate their strategic relationship and LRHS provided financial and strategic concessions to terminate the relationship. Upon termination of the strategic relationship, the System deconsolidated the LRHS assets acquired and liabilities assumed at their net book values and recognized an inherent distribution from deconsolidation of business combination of approximately \$585,952,000.

The System owns a 20% interest in OsceolaSC, LLC (OsceolaSC), a for-profit limited liability corporation. The remaining 80% is owned by Central Florida HMA Holdings, LLC, a subsidiary of Community Health Systems, Inc., a publicly held company. OsceolaSC owns and operates St. Cloud Regional Medical Center, an 84-bed hospital in Osceola County. The System's 20% interest in OsceolaSC is accounted for using the equity method with the accounts of OsceolaSC excluded from these consolidated financial statements.

Orlando Health has a 50% membership in South Lake Hospital, Inc. (South Lake), a not-for-profit acute care hospital. As Orlando Health does not hold a controlling interest in the accounts of South Lake, those accounts are excluded from these consolidated financial statements.

2. Significant Accounting Policies

Pending Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, to clarify the principles for recognizing revenue and improve financial reporting by creating common revenue recognition guidance for U.S. generally accepted accounting principles (U.S. GAAP) and International Financial Reporting Standards. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for these goods and services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The System is adopting ASU 2014-09 for the fiscal year ending September 30, 2019. The system plans to use the portfolio approach to apply the ASU to classes of payors with similar characteristics and cash collection trends will be analyzed over an appropriate look-back period depending on the payor. While management is continuing to evaluate the effects that the adoption of this standard will have on the consolidated

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

financial statements and disclosures, management expects a significant portion of the provision for bad debts to be recognized as a direct reduction to net patient service revenue as an implicit price concession, rather than its current presentation as a separate financial line item caption within the consolidated statement of operations and changes in net assets.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in ASU 2016-01 supersede the guidance to classify equity securities with readily determinable fair values into different categories and require equity securities to be measured at fair value with changes in the fair value recognized through net income. The amendments allow equity investments that do not have readily determinable fair values to be remeasured at fair value either upon an observable price change or upon identification of impairment, and require enhanced disclosures. In February 2018, the FASB issued ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments*, which clarifies certain aspects of the guidance issued in ASU 2018-01. ASU 2016-01 and ASU 2018-03 are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires a lessee to recognize a right-of-use asset and a lease liability for both operating and financing leases, whereas previous U.S. GAAP required the asset and liability to be recognized only for capital leases. The amendment also requires qualitative and specific quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The System is evaluating the guidance of ASU 2016-02 and the impact that the adoption of this ASU will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, as an update to Accounting Standards Codification (ASC) Topic 958, *Not-for-Profit Entities*. This update makes several improvements to current reporting requirements that address complexities in the use of the currently required three classes of net assets and enhance required disclosures related to donor restrictions of net assets. The updated guidance will be effective for annual periods beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted. The ASU should be applied on a retrospective basis. The updated guidance will result in a change in the classes of net assets reported on the face of the statement of financial position

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

from three classes (unrestricted, temporarily restricted, and permanently restricted) to two classes (net assets without donor restrictions and net assets with donor restrictions). No other material impact is expected. The System is currently evaluating the potential impact of the ASU on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. Current U.S. GAAP either is unclear or does not include specific guidance on eight cash flow classification issues. The amendments in ASU 2016-15 provide guidance for these eight issues, reducing the current and potential future diversity in practice. ASU 2016-15 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The System is evaluating the impact that the adoption of this update will have on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. Current U.S. GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. The amendments in ASU 2016-16 require recognition of the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual periods beginning after December 15, 2019. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. The amendments clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting, including acquisitions, disposals, goodwill, and consolidation. ASU 2017-01 is effective for fiscal years beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the test for goodwill impairment*. The amendments in ASU 2017-04 require an entity to perform its annual, or interim, goodwill impairment test by comparing the fair value of a

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Entities will continue to have the option to perform a qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASU 2017-04 is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05, *Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*. The amendments in ASU 2017-05 address the recognition of gains and losses on the transfer (sale) of nonfinancial assets to counterparties other than customers. ASU 2017-05 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. The amendments in ASU 2018-08 clarify accounting guidance for contributions received and contributions made. The amendments will assist entities in: (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions), or as exchange (reciprocal) transactions, and (2) determining whether a contribution is conditional. For contributions received, ASU 2018-08 is effective for annual periods beginning after June 15, 2018, and interim periods within those annual periods. For contributions made, ASU 2018-08 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in ASU 2018-13 modify the disclosure requirements on fair value measurements in Topic 820, *Fair Value Measurement*. ASU 2018-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Investments with maturities of three months or less when purchased are classified as cash equivalents. Cash deposits are federally insured in limited amounts.

Investments and Investment Income

Investments in marketable equity securities and all debt securities are stated at fair value in the consolidated balance sheets. All investments have been designated by management as trading securities. Investment income or loss, including realized and unrealized gains and losses, interest, and dividends, is included in excess of revenues, other support, and gains over expenses and losses, unless the income or loss is restricted by donor or law. The System classifies unrestricted investments, regardless of maturity date, as either short-term or long-term based on management's intent and ability to hold or reinvest the investments on a long-term basis.

Investments Without Readily Determinable Values

Investments without readily determinable values consist of funds-of-funds, investments in private equity companies, partnerships, and limited liability companies and are included with investments at fair value. Under U.S. GAAP, a reporting entity is permitted, as a practical expedient, to estimate the fair value of such an investment using the net asset value per share (or its equivalent, such as member units or an ownership interest in partners' capital to which a proportionate share of net assets is attributed) of certain investments, if the net asset value per share of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of investment funds. At September 30, 2018 and 2017, the net asset value approximates the fair value of the funds as reported by the investment fund managers. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market of these investments existed, and the differences could be material.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

Income Taxes

Orlando Health, Inc. and its non-profit affiliates are exempt from federal income taxes under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and are also exempt from state income taxes. Healthnet Services, Inc. and its subsidiaries are taxable corporations and file a consolidated federal and state tax return. The System, on a consolidated basis, has not generated taxable income for the years ended September 30, 2018 and 2017. Taxable income, if any, is immaterial to the System on a consolidated basis. However, the System's effective tax rate was 3.75% (\$639,000 tax benefit) for the year ended September 30, 2018 compared to 0% for the year ended September 30, 2017. The current year effective tax rate is driven by the re-measurement of certain deferred tax liabilities related to indefinite lived intangibles and goodwill to which a corresponding valuation offset is not considered.

At September 30, 2018 and 2017, the Company has combined net deferred tax assets of approximately \$27,071,000, and \$28,180,000, respectively. Deferred tax assets are primarily composed of federal and state net operating loss carryforwards. At September 30, 2018 and 2017, the Company had combined approximately \$117,261,000 and \$97,823,000, respectively, of federal net operating loss carryforwards and \$117,261,000 and \$97,823,000 of state net operating carryforwards. These net operating losses will expire between 2020 and 2038. Under the Tax Cuts and Jobs Act of 2017 (*Tax Act*), net operating losses incurred in 2018 and in future years will not expire. However, these net operating losses will be limited to 80% on a carryforward basis. A valuation allowance has been provided to offset the full amount of deferred tax asset as of September 30, 2018 and 2017, as management determined that it is more likely than not that the benefit of the deferred tax assets will not be realized in future periods.

FASB ASC Topic 740, *Income Taxes*, prescribes the accounting for uncertainty in income tax positions recognized in the financial statements. ASC Topic 740 provides guidance and measurement of a tax position taken or expected to be taken in a tax return. There were no material uncertain tax positions as of September 30, 2018 and 2017.

On December 22, 2017, the Tax Act was signed into law making significant changes to the Internal Revenue Code. The changes include, but are not limited to, a federal statutory rate reduction from 34.0% to 21.0%, the elimination of U.S. federal alternative minimum tax, the transition of U.S. international taxation from a worldwide tax system to a territorial system and a one-time transition tax on the mandatory redeemed repatriation of cumulative foreign earnings. For tax-exempt

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

organizations, the Act imposes an excise tax on compensation paid in excess of \$1,000,000 to certain executives, subjects certain fringe benefits to taxation as unrelated business income, requires organizations to separately compute Unrelated Business Income (UBI) for each trade or business, and repeals the exempt status of advance refunding bond issuances. The key provision of the Tax Act on the financial statements for the tax year ended September 30, 2018 was the re-measurement of deferred tax balances in accordance with the new corporate tax rate. The re-measurement of the System's deferred tax balances resulted in a \$3,479,000 decrease to the System's net deferred tax asset with a corresponding \$4,118,000 valuation allowance offset. The \$639,000 tax benefit is due to the re-measurement of certain deferred tax liabilities related to indefinite lived intangibles and goodwill to which a corresponding valuation offset is not considered. The regulations necessary to implement the law have not yet been promulgated, and the ultimate outcome of these regulations and the impact to Orlando Health cannot be fully determined. We will continue to review and assess the impact of the legislation to the financial statements.

Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under bond indenture agreement, assets whose use is limited due to statutory requirements of the state of Florida for future malpractice claims and collateral held for an interest rate swap agreement. Amounts required to meet related current liabilities are reported as current.

Restricted Investments

Restricted investments consist of investments held by the Orlando Health Foundation that are restricted as to use by donors for a specific time period or purpose.

Inventory

Inventory which consists primarily of medical and drug supplies, is stated at the lower of cost or market value. Cost is determined using the first-in, first-out method. In 2017, the System revised its accounting for surgical inventory resulting in an increase to the surgical inventory for the initial recognition of such inventory on hand at the beginning of the year, which had previously been expensed as purchased within the supplies and other expense financial statement caption of \$18,372,000. Inventory was separately reclassified from other current assets in the consolidated balance sheets into its own financial statement caption.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are recorded at cost, except for donated items, which are recorded at fair value at the date of the contribution. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized, as are interest costs during periods of construction. Depreciation is computed utilizing the straight-line method at rates estimated by management to amortize the cost of the various assets within the periods of expected use.

Goodwill and Other Intangible Assets

Goodwill results from the excess of the purchase price over the fair value of net assets of investments accounted for under the equity method and acquisitions accounted for as business combinations. Goodwill amounted to \$76,621,000 and \$76,061,000 at September 30, 2018 and 2017, respectively, and is included in other assets on the consolidated balance sheets. The System prepares its annual impairment analysis as of March 31 of each fiscal year. The impairment test results did not identify any impairment in any of the years presented as of September 30, 2018 and 2017, respectively.

Investments in Related Parties

Investments in related parties in which the System owns or controls at least a 20% interest and less than a 50% voting interest are recorded using the equity method. Investments in related parties of less than a 20% interest are recorded using the cost method, and income is recognized only when cash dividends are received. Income or losses from equity investments and cash dividends received from cost method investments are included in other revenue.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

If indicators of impairment are present, the System evaluates the financial recoverability of long-lived assets by comparing their carrying value to the expected future undiscounted cash flows. If such evaluations indicate that the carrying value of the assets has been impaired, the assets are adjusted to their fair values. Additionally, long-lived assets held for sale are similarly evaluated by comparison of the carrying value to fair value less costs to sell. If the carrying value exceeds fair value less costs to sell, the assets are adjusted to fair value less costs to sell. Adjustments are reported as impairment expense. There was no impairment of long-lived assets in the years ended September 30, 2018 and 2017.

Unrestricted Gifts

Unconditional promises to give cash and other assets to the System are reported at fair value as of the date the promise is received. Unrestricted gifts are recognized in other revenue.

Donor-Restricted Gifts

Conditional promises to give and indications of intentions to give are reported at fair value as of the date the gift is received. Gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit their use. Temporarily restricted net assets and the income from permanently restricted net assets are generally used for clinical department operational expenses and capital purchases. Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity. When a stipulated time restriction ends or a restricted purpose is accomplished, temporarily restricted net assets are released from restrictions. Gifts restricted by time or operating purposes are held in temporarily restricted net assets until the funds are spent or at the end of time restrictions, at which time the funds are released and reported as net assets released from restrictions in the consolidated statements of operations and changes in net assets. Gifts restricted for property and equipment purchases are held in temporarily restricted net assets until spent, at which time they are released and reported as net assets released from restrictions for property and equipment in unrestricted changes in net assets.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

The following outlines the nature of restricted net assets. For permanently restricted gifts, only income is available to spend:

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Temporarily restricted net assets		
Operations	\$ 78,842	\$ 81,693
Property and equipment	30,966	83,534
Research, education, and other	14,817	8,895
	<u>\$ 124,625</u>	<u>\$ 174,122</u>
Permanently restricted net assets		
Operations	\$ 836	\$ 836
Research, education, and other	609	547
	<u>\$ 1,445</u>	<u>\$ 1,383</u>

Net Patient Service Revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established charges. Payment arrangements include prospectively determined rates per discharge, discounted charges, and percentages of Medicare fee schedules for physician services. The System, excluding LRHS, also provides a 50% discount for 2018 and 65% discount for 2017 from established charges to uninsured patients. As it pertains to LRHS, the System's policy is to provide an uninsured patient that did not qualify for financial assistance and whose income is greater than 400% of the Federal Poverty Guidelines a discount that is calculated using a 'look-back' method. Each year, claims for services provided during the prior 12-month period ended September 30, which were paid in full by Medicare fee-for-service and private insurers are analyzed to compute the discount percentage. The amount of discount provided to the uninsured in 2018 was 75% of standard rates. Net patient service revenue is presented net of such discounts for uninsured patients that totaled approximately \$417,385,000, with \$171,247,000 attributed to LRHS, and \$196,490,000 for the years ended September 30, 2018 and 2017, respectively. The System has determined, based on an assessment at the reporting-entity level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay, and as such, the entire provision for bad debts is recorded as a deduction from net patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

Net patient service revenue is reported at estimated net realizable amounts due from patients and third-party payors for medical services rendered and includes adjustments resulting from reviews and audits of prior year Medicare and Medicaid cost reports. Such adjustments are considered in the recognition and estimation of revenue in the current and future periods as the adjustments become known or as cost report years are no longer subject to such reviews and audits. The combined effect from changes of all prior year cost report settlements and adjustments was an increase in net patient service revenue of approximately \$4,248,000 and \$1,363,000 for the years ended September 30, 2018 and 2017, respectively. Of the increase in 2018, \$3,321,000 was attributed to LRHS.

The percentage of estimated net patient service revenue (net of contractual allowances and discounts) by payor type based on primary insurance is presented below. Patient deductibles and co-pays, as well as accounts whose qualification for the Medicaid program is pending, are included in third-party payors amounts.

	Year Ended September 30	
	2018	2017
Third-party payors	94%	97%
Patients	6	3
	100%	100%

Approximately 23% and 24% of net patient service revenue was earned under the Medicare and Medicare HMO programs for the years ended September 30, 2018 and 2017, respectively, and 10% and 11% earned under state Medicaid and Medicaid HMO programs (including estimated revenue for patients whose qualification for the Medicaid program is pending) for the years ended September 30, 2018 and 2017, respectively. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimates will change by a material amount in the near term.

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 necessarily limited to, matters such as licensure, accreditation, participation requirements of government health care programs, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services, and could have a material impact on the consolidated financial statements.

The Centers for Medicare and Medicaid Services (CMS) utilizes Recovery Audit Contractors (RAC) to retroactively review the propriety of payments to hospitals and physicians for services rendered. During the RAC demonstration project, CMS began recouping amounts previously paid to the System based upon a review of medical records.

The System was a part of the demonstration project that reviewed claims from 2002 to 2006, and for 2008 claims, and is subject to the RAC program that was made permanent by Section 302 of the Tax Relief and Healthcare Act of 2006. The System considered its history of denied claims and successful appeals of previously denied claims in estimating its valuation allowances for exposure to RAC audits.

The complexities of the Medicare and Medicaid program rules and the nature of the RAC audit process provide at least a reasonable possibility that the System's valuation allowances for exposure to the RAC audit may change in the near term. The effect of the RAC's recouping of amounts previously paid to the System, net of estimated amounts due, was a reduction in net patient service revenue of approximately \$679,000 for the year ended September 30, 2018 and a reduction in net patient service revenue of \$7,448,000 for the year ended September 30, 2017.

The System received \$277,000 and \$1,294,000 during the years ended September 30, 2018 and 2017, respectively, in incentives under the Medicare and Medicaid Electronic Medical Record incentive program as authorized by the Health Information Technology for Clinical Health Act (HITEC). The System adopted the gain contingency income recognition model for HITEC and recognizes income after the System has demonstrated meaningful use of certified electronic health record technology for the applicable compliance period and the cost report period that will be used to determine the final incentive payment has ended. The System defers income on its consolidated balance sheets for any incentive payments received, but not yet earned. All payments received to date have been earned and recognized as other revenue. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost report data that is subject to audit.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

The System grants credit without collateral to its patients, most of whom are local residents, insured under third-party payor agreements. The mix of receivables from patients and third-party payors before allowances for doubtful accounts is as follows:

	September 30	
	2018	2017
Medicare	17%	21%
Medicaid	12	14
Other third-party payors	46	47
Patients	25	18

Allowances for Doubtful Accounts

The provision for bad debts is based upon management's assessment of historical and expected collections of accounts receivable considering business and economic conditions, trends in health care coverage, and other collection indicators. Accounts receivable are written off and charged to the provision for bad debts after collection efforts have been followed in accordance with the System's policies. Recoveries are treated as a reduction to the provision for bad debts.

Accounts receivable are reduced by an allowance for doubtful accounts. Periodically, management performs a review and assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category.

Data related to payor sources of revenue and the results of this review are then used to establish an appropriate allowance for uncollectible receivables and provision for bad debts. Additionally, for receivables associated with services provided to patients who have third-party coverage, contractually due amounts are analyzed and compared to actual cash collected over time to enhance the quality of the estimate of the allowance for doubtful accounts and the provision for bad debts (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), a significant allowance for doubtful accounts is recorded on the basis of historical experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

An estimate of the difference between contracted rates and amounts actually collected, after all reasonable collection efforts have been exhausted, is charged to the provision for bad debts and credited to the allowance for doubtful accounts.

Allowances for doubtful accounts increased approximately \$88,393,000 during the year ended September 30, 2018, from \$160,404,000 at September 30, 2017, to \$248,797,000 at September 30, 2018. The allowance for doubtful accounts includes approximately \$78,117,000 and \$58,886,000 in amounts due from third-party payors, including the patient responsibility portion included in these accounts at September 30, 2018 and 2017, respectively. The allowance for doubtful accounts for self-pay hospital patients as a percent of related self-pay accounts receivable was 96% and 95% at September 30, 2018 and 2017.

The provision for bad debts increased from approximately \$144,060,000 for the year ended September 30, 2017, to \$421,614,000 for the year ended September 30, 2018 with approximately \$107,412,000 attributed to LRHS. During the year ended September 30, 2017, the System determined there were a significant number of previously reserved patient accounts that qualified for charity status. During 2017 the related amounts were reclassified from the provision for bad debts to charity care, resulting in a reduction to the provision for bad debt and an increase in charity care. While accounts were reclassified again in the year ended September 30, 2018 it was not to the volume that was experienced in the year ended September 30, 2017. Therefore, the provision for bad debts in the year ended September 30, 2018 is higher due to not having the offset transactions as in the year ended September 30, 2017. This change is not expected to have an impact on net patient service revenue less provision for bad debts because charity services are not recorded as revenue. In addition, the self pay discount was decreased from 65% to 50% in fiscal year 2018 which leaves a larger balance that can potentially be classified to bad debt expense.

Charity Care

The System provides care to patients who meet certain criteria under its charity care policy at no charge or at amounts less than its established charges. Because the System does not pursue collection of amounts determined to qualify as charity care, such amounts are excluded from net patient service revenue. Patients are eligible for charity care if their documented household income is less than 225% of the federal poverty level guidelines, or the amount of their medical bill is more than 25% of their annual household income and their household income does not exceed 400% of the federal poverty level guidelines. Charity care is provided to all patients meeting these criteria. Charity care provided was approximately 5% of total services rendered during the years

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

ended September 30, 2018 and 2017, based on total charges for all services in those years. The estimated cost of charity care delivered was approximately \$123,558,000, with \$24,620,000 attributed to LRHS, and \$105,580,000 during the years ended September 30, 2018 and 2017, respectively. Cost is estimated based on the System's ratio of expenses to established patient service charges.

Estimated Malpractice Costs

The provision for estimated medical malpractice expense is an estimate of the ultimate cost of reported claims and claims incurred, but not reported.

Derivative Instruments and Hedging Activities

The System has entered into derivative transactions in the form of interest rate swap agreements which it uses to manage the relative amounts of fixed and variable rate long-term debt exposure. The interest rate swap agreements are contracts between the System and a third-party (counterparty) that provide for economic payments between the parties based on specified notional amounts and defined interest rates. The interest rate swap agreements are exposed to counterparty credit risk, which is the risk that contractual obligations of the counterparty will not be fulfilled. All realized and unrealized interest rate swap agreement gains and losses are included in nonoperating gains and losses on the consolidated statements of operations and changes in net assets. Collateral posted under interest rate swap contracts is recorded gross of the related asset or liability and classified as assets limited as to use when held by the counterparty and as other noncurrent liability when held by the System.

Functional Expenses

The System does not present expense information by functional classification since substantially all of its activities and resources are derived from the provision of health care services in a manner similar to that of a business enterprise. Other financial indicators included in these consolidated financial statements are important in evaluating how well management has discharged its stewardship responsibilities.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

2. Significant Accounting Policies (continued)

Excess of Revenues, Other Support, and Gains Over Expenses and Losses

The consolidated statements of operations and changes in net assets include excess of revenues, other support, and gains over expenses and losses, which is analogous to income from continuing operations for a for-profit enterprise. Nonoperating gains and losses represent activities peripheral to direct patient care services and include investment income, change in fair value of interest rate swap agreements, and loss on early extinguishment of debt. Changes in unrestricted net assets that are excluded from excess of revenues, other support, and gains over expenses and losses, consistent with industry practice, primarily include contributions of long-lived assets, including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets.

3. Fair Value Measurements

The System follows ASC 820, which provides a framework for measuring the fair value of certain assets and liabilities and disclosures about fair value measurements. As defined in ASC 820, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

Certain of the System's financial assets and financial liabilities are measured at fair value on a recurring basis, including money market, fixed income and equity instruments, and interest rate swap agreements. The three levels of the fair value hierarchy defined by ASC 820 and a description of the valuation methodologies used for instruments measured at fair value are as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities as of the reporting date.

Level 2 – Observable pricing inputs other than quoted prices included within Level 1, including quoted market prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable or are derived principally from, or corroborated by, observable market data by correlation or other means.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

3. Fair Value Measurements (continued)

Level 3 – Unobservable pricing inputs that are supported by little or no market activity, are significant to the fair value of the assets or liabilities, and reflect our own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument in accordance with the provisions of ASC 820:

Cash and cash equivalents: The carrying amount reported in the consolidated balance sheets approximates fair value.

Long-term investments and assets limited as to use: The carrying amount reported in the consolidated balance sheets is fair value, based on quoted market prices, or estimated using quoted market prices for similar securities.

Investments in related parties: The fair value of investments in related parties is not practicable to estimate due to the uncertainty regarding the timing of future payments.

Long-term debt: Fair value of fixed rate debt is estimated based on applicable quoted interest rate yield curves applied to the outstanding issues as of the end of each period. The carrying value of variable rate debt approximates its fair value.

Interest rate swap agreements: Assets are included in other assets, and liabilities are included in other noncurrent liabilities. Estimates are based on quoted market prices or estimated based on derivative pricing models that involve adjusting the periodic mid-market values to incorporate nonperformance risk of the System when the financial instrument is a liability or the nonperformance risk of the counterparty when the financial instrument is an asset.

Deferred compensation plans: Investments held in conjunction with the System's 457(b) and 409(a) deferred compensation plans amount to approximately \$35,309,000 and \$28,656,000 as of September 30, 2018 and 2017, respectively, and are included in other assets. These investments are valued using unadjusted quoted prices in active markets and are considered Level 1 assets.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

3. Fair Value Measurements (continued)

The derivative valuations determined by mid-market quotations are considered Level 2 assets or liabilities since quoted prices can be obtained from a number of dealer counterparties and other independent market sources based on observable interest rates and yield curves for the full term of the asset or liability.

The estimated fair value of interest rate swap agreements that hedge interest rate fluctuations on variable rate bonds and loans is presented below. These amounts are included in other noncurrent liabilities in the accompanying consolidated balance sheets.

	Asset (Liability)	
	September 30	
	2018	2017
	<i>(In Thousands)</i>	
2011 swaps	\$ (22,397)	\$ (30,559)
2008E swap	(3,341)	(5,358)

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

3. Fair Value Measurements (continued)

The following table represents the fair value hierarchy of the System's financial assets and liabilities measured at fair value using the market approach as of September 30, 2018 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets				
Mutual funds	\$ 826,347	\$ —	\$ —	\$ 826,347
Equity securities	120	—	—	120
U.S. corporate bonds	—	112,723	—	112,723
U.S. Treasury and agency obligations	—	108,600	—	108,600
International bonds	—	646	—	646
Mortgage-backed obligations	—	182,398	—	182,398
Municipal bonds	—	888	—	888
Cash and cash equivalents	191,025	—	—	191,025
	<u>\$ 1,017,492</u>	<u>\$ 405,255</u>	<u>\$ —</u>	<u>\$ 1,422,747</u>
Investments measured at net asset value				363,276
Interest rate swap contract collateral				4,595
Total financial assets at fair value				<u>\$ 1,790,618</u>
Financial liabilities				
Interest rate swap agreements	\$ —	\$ 25,738	\$ —	\$ 25,738
	<u>\$ —</u>	<u>\$ 25,738</u>	<u>\$ —</u>	<u>\$ 25,738</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

3. Fair Value Measurements (continued)

The following table represents the fair value hierarchy of the System's financial assets and liabilities measured at fair value using the market approach as of September 30, 2017 (in thousands):

	Level 1	Level 2	Level 3	Total
Financial assets				
Mutual funds	\$ 643,316	\$ –	\$ –	\$ 643,316
Equity securities	57,471	–	–	57,471
U.S. corporate bonds	–	132,849	–	132,849
U.S. Treasury and agency obligations	12,182	100,245	–	112,427
International bonds	–	484	–	484
Mortgage-backed obligations	–	36,771	–	36,771
Municipal bonds	–	948	–	948
Cash and cash equivalents	26,191	–	–	26,191
Real estate investment trusts	–	20	–	20
	<u>\$ 739,160</u>	<u>\$ 271,317</u>	<u>\$ –</u>	<u>\$ 1,010,477</u>
Investments measured at net asset value				340,281
Interest rate swap contract collateral				14,258
Total financial assets at fair value				<u>\$ 1,365,016</u>
Financial liabilities				
Interest rate swap agreements	\$ –	\$ 35,917	\$ –	\$ 35,917
	<u>\$ –</u>	<u>\$ 35,917</u>	<u>\$ –</u>	<u>\$ 35,917</u>

Total financial assets at fair value of \$1,791,000 and \$1,365,000 as of September 30, 2018 and 2017, respectively, is composed of the following financial statement captions within the consolidated balance sheets: Debt service and reserve funds held by bond trustee, Interest rate swap contract collateral, Malpractice self-insurance, Long-term investments – unrestricted and Long-term investments – restricted.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

3. Fair Value Measurements (continued)

The following table shows the System's investments in commingled funds by asset class along with commitments and redemption ability as of September 30, 2018 (in thousands):

	<u>Net Asset Value</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Equity Fund – Large Cap Core ^(a)	\$ 173,492	Daily	2 days
Equity Fund – International Large Cap ^(b)	89,336	Daily	30 days
Real Estate – Real Assets ^(d)	28,873	Quarterly	45 days
Real Estate – Real Assets ^(e)	1,649	Quarterly	60 days
International Small Cap – Ltd Ptnership ^(f)	27,908	Monthly	30 days
Small/Mid-Cap LLC ^(h)	42,018	Monthly	5 days
	<u>\$ 363,276</u>		

The following table shows the System's investments in commingled funds by asset class along with commitments and redemption ability as of September 30, 2017 (in thousands):

	<u>Net Asset Value</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Equity Fund – Large Cap Core ^(a)	\$ 132,252	Daily	2 days
Equity Fund – International Large Cap ^(b)	11,512	Daily	30 days
Hedge fund – Absolute Return ^(c)	62,722	Monthly	5 days
Real Estate – Real Assets ^(d)	27,640	Quarterly	45 days
Real Estate – Real Assets ^(e)	1,546	Quarterly	60 days
International Small Cap – Ltd Ptnership ^(f)	25,486	Monthly	30 days
High Yield Bond Ltd Ptnrship ^(g)	12,901	Monthly	10 days
Small/Mid-Cap LLC ^(h)	66,222	Monthly	5 days
	<u>\$ 340,281</u>		

^(a) This fund provides passive exposure to the U.S. equity market and is a low-cost index replicator. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this fund.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

3. Fair Value Measurements (continued)

- (b) This fund invests in international large cap equities and seeks to diversify the growth portfolio beyond U.S. macro economic factors. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this fund.
- (c) This fund is a global absolute return hedge fund of funds. They provide an absolute return that exceeds that of the fixed income oriented investments with less risk than growth assets. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this fund.
- (d) & (e) These real asset funds have holdings including but not limited to apartment building and office building properties. These properties are located throughout the U.S. They are intended to protect the real value of the portfolio. When inflation increases the nominal value of the dollar, assets in this category should also increase in value. The funds portfolio construction makes them a diversifier to other core funds. The fair value of the investments in these groups have been estimated using the net asset values of the System's interest in these funds.
- (f) This international small-cap stock limited partnership has a value-aware approach to stock picking. The fair value of the investments in this fund has been estimated using the net asset value of the System's interest in this limited partnership.
- (g) This fund is a high-yield bond limited partnership and provides the growth portfolio with return-enhancing characteristics and diversifies by investing in assets with modest correlation to both equity and fixed income. This fund attempts to avoid absolute risk through disciplined credit analysis. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this limited partnership.
- (h) This small-mid-cap fund enhances returns by focusing on smaller cap U.S. companies. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this LLC.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

4. Investments

Investment income consists of the following:

	Year Ended September 30	
	2018	2017
	<i>(In Thousands)</i>	
Interest and dividend income	\$ 35,060	\$ 24,826
Change in unrealized gains and losses	(3,940)	50,228
Net realized gains on sales of securities	40,836	8,509
	<u>\$ 71,956</u>	<u>\$ 83,563</u>

5. Investments in Related Parties

OsceolaSC, LLC

On February 1, 2006, the System sold the property and equipment of St. Cloud Hospital to OsceolaSC partnership, in which the System holds a 20% interest. As a result of this transaction, the property and equipment of St. Cloud Hospital were released from the mortgage securing repayment of Orlando Health's bond issues. The System's equity investment in OsceolaSC is included in investments in related parties and amounted to \$13,147,000 and \$12,628,000 at September 30, 2018 and 2017, respectively. Earnings on the investment before cash distributions are included in other revenue and amounted to approximately \$2,177,000 and \$1,705,000 for the years ended September 30, 2018 and 2017, respectively.

South Lake

Effective October 1, 1995, the System entered into an arrangement with South Lake County Hospital District (the South Lake District), whereby the two entities formed South Lake, a Section 501(c)(3) not-for-profit corporation. Under the terms of the joint venture, the South Lake District leased its hospital assets to South Lake for 99 years. The System invested \$7,400,000 with the South Lake District for the purpose of establishing a new foundation for health and other charitable services to South Lake County and invested \$500,000 with South Lake. In exchange for the cash invested with the South Lake District, the System received an option to purchase the leased assets and transfer them to South Lake at any time throughout the 99-year lease period. These amounts

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

5. Investments in Related Parties (continued)

are included in investments in related parties in the consolidated financial statements. The System's equity investment in South Lake is included in investments in related parties and amounted to approximately \$9,208,000 and \$9,272,000 at September 30, 2018 and 2017, respectively. The System has no rights to the profits or obligations for the losses of South Lake. The System agreed to extend a line of credit, not to exceed \$7,400,000 to South Lake, if needed, with repayments, including interest at the prime rate. The System provided management services to South Lake in the amount of approximately \$6,500,000 and \$6,200,000 during 2018 and 2017, respectively, at cost according to the terms of a Management Agreement.

On May 14, 2010, South Lake issued \$34,330,000 of Revenue Bonds, Series 2010 (2010 Bonds), and used the proceeds to refund its Revenue Bonds, Series 1999 (1999 Bonds), for the purpose of reducing future debt service. The System guarantees the 2010 Bonds as it did the 1999 Bonds. As of September 30, 2018, \$28,655,000 of the 2010 Bonds was outstanding. As of January 22, 2019, no payments have ever been made or requested under the line of credit or guaranty, and in the opinion of management of the System, no funding of such guaranteed indebtedness will be necessary.

CareSpot

On September 1, 2017, the System entered into a joint venture with CareSpot Urgent Care to provide urgent/non-emergent care throughout Orlando and Central Florida. There are currently ten locations. The System holds a 49.9% interest in the joint venture. The System's equity investment in CareSpot is included in investments in related parties and amounted to approximately \$8,668,000 and \$8,144,000 at September 30, 2018 and 2017, respectively. Earnings on the investment before cash distributions are included in other revenue and amounted to approximately \$524,000 and \$0 for the years ended September 30, 2018 and 2017, respectively.

The remaining balance consists of various smaller investments in related parties that aggregate to a total of approximately \$10,844,000 and \$7,455,000 for the years ended September 30, 2018 and 2017, respectively.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

6. Property and Equipment

Property and equipment consist of the following:

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Land and improvements	\$ 179,642	\$ 145,207
Buildings	1,053,823	1,002,808
Equipment	1,896,951	1,803,306
	<u>3,130,416</u>	<u>2,951,321</u>
Less: Accumulated depreciation	<u>(1,824,596)</u>	<u>(1,700,038)</u>
	1,305,820	1,251,283
Construction-in-progress	159,730	50,616
	<u>\$ 1,465,550</u>	<u>\$ 1,301,899</u>

Construction

Construction-in-progress represents numerous construction and renovation projects. Estimated costs to complete these projects as of September 30, 2018, are approximately \$185,121,000, which includes \$23,503,000 for Freestanding ED- Osceola, \$59,680,000 for Freestanding ED- Seminole, \$10,157,000 for 11th floor North Bed Tower Buildout, and \$18,631,000 for an on-campus skilled nursing facility at Health Central. Projects will be funded through operating cash flow and pledges received.

Equipment includes approximately \$9,902,000 of costs associated with information system projects-in-progress at September 30, 2018. Estimated costs to complete these projects as of September 30, 2018, are approximately \$12,730,000, and are expected to be paid from future cash flow or unrestricted cash on hand.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

6. Property and Equipment (continued)

Lucerne Facility

During the year ended September 30, 2014, the acute care hospital operations of Lucerne were consolidated into the main buildings of ORMC. The inpatient acute care portion of Lucerne ceased operations, but the remaining building continued operating as a rehabilitation center, and the process for selling the Lucerne facility commenced. In January 2014, a developer began negotiations to purchase the Lucerne facility that involved two closings over approximately two years. During the year ended September 30, 2015, the proposed sale of the Lucerne facility did not occur, but the acute inpatient portion of the property was demolished as planned. As a result, the property was divided into a parcel of vacant land to be held for sale, and a parcel with a building to continue being held and used. In March 2015, the vacant land being held for sale was reclassified to assets held for sale. At September 30, 2016, the fair value of assets held for sale was \$8,596,000. In October 2016, a portion of the land was retained and reclassified to property and equipment for \$1,750,000. The remaining property was sold in November 2016 for \$8,767,000, resulting in a gain of \$1,921,000.

Leases

The System leases property and equipment for a variety of purposes under operating leases. Operating lease expense is classified as supplies and other expenses and amounted to \$36,834,000 and \$29,268,000 for the years ended September 30, 2018 and 2017, respectively.

Assets capitalized under capital leases as reflected in the accompanying consolidated balance sheets were \$21,000,000 and \$21,000,000 of buildings and fixed equipment at September 30, 2018 and 2017, respectively. The accumulated depreciation related to assets under capital leases was \$2,217,000 and \$817,000 at September 30, 2018 and 2017, respectively. Depreciation of assets under capital leases is included in depreciation expense.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

7. Long-Term Debt

Long-term debt consists of the following:

	September 30	
	2018	2017
	<i>(In Thousands)</i>	
Fixed Rate Hospital Revenue Bonds – secured		
Series 2018 – plus net unamortized premium and issuance costs of \$2,873,000 and \$0 at September 30, 2018 and September 30, 2017, respectively; interest rates from 2.278% to 4.089%, payable through 2049	\$ 472,127	\$ –
Series 2016A – plus net unamortized premium and issuance costs of \$25,755,000 and \$27,338,000 at September 30, 2018 and September 30, 2017, respectively; interest rates from 3.0% to 5.0%, payable through 2041	199,470	201,053
Series 2016B (Orlando Health Central) – less unamortized issuance costs of \$3,747,000 and \$3,886,000 at September 30, 2018 and September 30, 2017, respectively; interest rates from 4.0% to 5.0%, payable 2045 through 2046	70,322	70,461
Series 2016C (Orlando Health Central) – less unamortized issuance costs of \$1,088,000 and \$1,078,000 at September 30, 2018 and September 30, 2017, respectively; interest rates of 4.416%, payable 2044 through 2045	73,387	73,347
Series 2012A and B – plus net unamortized premium and issuance costs of \$3,141,000 and \$3,109,000 at September 30, 2018 and September 30, 2017, respectively; interest rates from 4.0% to 5.0%, payable through 2043	187,984	188,113
Series 2009 – less net unamortized premium and issuance costs of \$79,000 and \$88,000 at September 30, 2018 and September 30, 2017; respectively; interest rates from 5.0% to 5.375%, payable through 2027	158,081	161,221
Series 2008A and B – less net unamortized premium and issuance costs of \$0 and \$1,215,000 at September 30, 2018 and September 30, 2017, respectively; interest rates from 4.0% to 5.25%, payable through 2036; Series 2008A and B were partially advance refunded as of April 2016 and fully advance refunded as of February 2018	–	81,795
Series 1996A and Series 1996C – plus net unamortized premium and issuance costs of \$0 and \$130,000 at September 30, 2018 and September 30, 2017, respectively; interest rate of 6.25%, payable through 2022. Series 1996 were advance refunded as of February 2018	–	41,855
Variable rate hospital revenue bonds – secured		
Series 2011 – interest rates of 2.0721% and 1.6813% at September 30, 2018 and September 30, 2017, respectively, less unamortized issuance costs of \$244,000 and \$252,000 at September 30, 2018 and September 30, 2017, respectively, payable 2027 through 2041	82,931	82,923
Series 2008E – interest rates of 1.58% and 0.93% at September 30, 2018 and September 30, 2017, respectively, less unamortized issuance costs of \$176,000 and \$198,000 at September 30, 2018 and September 30, 2017, respectively, payable through 2026	48,359	49,842
Notes payable and other indebtedness		
Capital lease obligations and other notes	30,162	32,082
Total debt, net of unamortized premiums, discounts and issuance costs	1,322,823	982,692
Less current portion	(22,152)	(23,288)
Total long-term debt	\$ 1,300,671	\$ 959,404

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

7. Long-Term Debt (continued)

Aggregate principal amounts of long-term debt outstanding, excluding premiums, discounts, and issuance costs are due during the following years ending September 30: \$22,152,000 in 2019, \$24,587,000 in 2020, \$25,616,000 in 2021, \$26,292,000 in 2022, \$26,977,000 in 2023, and \$1,165,503,000 thereafter.

Master Trust Indenture

Orlando Health along with Health Central comprise the Obligated Group created under the Master Trust Indenture. The Obligated Group is obligated for the payment of principal and premium, if any, and interest on any outstanding bonds or debt issued under the Master Trust Indenture, and is subject to any other obligation or restriction set forth in any agreement, note, or indenture entered into or issued by the Obligated Group in connection with the issuance of any debt or related obligations issued under the Master Trust Indenture.

An Amended and Restated Master Indenture (Master Indenture), dated as of August 1, 1999, was executed by Orlando Health. All obligations issued under the Master Indenture are equally and ratably secured by a pledge of the accounts (as defined in Article 9 of the Florida Uniform Commercial Code) and the Gross Revenue of the Obligated Group. The Master Indenture provides for specific restrictive covenants, including a debt service coverage requirement. Financial information of the Obligated Group is included in the Supplementary Information appearing on pages 47 and 48.

Hospital Revenue Bonds, Series 2018

On February 1, 2018, Orlando Health, Inc. issued \$475,000,000 taxable fixed rate hospital revenue bonds on behalf of the Obligated Group through its Series 2018 Bonds. The proceeds of the Series 2018 Bonds were applied for general corporate purposes including construction and renovation of facilities and used to advance refund all of the outstanding Series 1996A, Series 1996C, Series 2008A, and Series 2008B Bonds. The System recorded a loss from early extinguishment of debt of \$4,707,000, which is included in nonoperating gains and losses in the consolidated statement of operations and changes in net assets.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

7. Long-Term Debt (continued)

Hospital Revenue Bonds, Series 2016A, B, and C

On April 27, 2016, the Orange County Health Facilities Authority (Authority) issued \$173,715,000 and \$66,575,000 tax-exempt fixed rate bond obligations on behalf of the Obligated Group through its Series 2016A Bonds and Series 2016B Bonds, respectively. The proceeds of the Series 2016A Bonds were used to currently refund all of the outstanding Series 2006B Bonds, advance refund \$11,635,000 of the outstanding Series 2008A Bonds, advance refund \$43,855,000 of the Series 2008B Bonds, and advance refund all of the Series 2008C Bonds. The proceeds of the Series 2016B Bonds were used by Health Central to refinance \$70,645,000 of the \$141,120,000 outstanding on the note payable to the West Orange Healthcare District. At the same time, the Obligated Group issued \$74,465,000 of taxable fixed rate bond obligations through its Series 2016C Bonds. The proceeds of this bond obligation issue were used to refinance the remaining balance of the note payable to the West Orange Healthcare District.

Hospital Revenue Bonds, Series 2008E

The Series 2008E bonds are supported by an irrevocable letter of credit with Branch Banking and Trust Company, which has an expiration date of June 18, 2020.

Hospital Revenue Bonds, Series 2011

On September 15, 2011, the Authority issued \$83,175,000 of variable rate Hospital Revenue Bonds (2011 Bonds) on behalf of Orlando Health. The proceeds from the sale of the 2011 Bonds and \$7,239,000 of remaining 2007A Bonds debt service reserve funds were used to currently refund the 2007A Bonds and pay the costs of issuance of the 2011 Bonds. The 2011 Bonds were issued as tax-exempt, multi-modal bonds, initially operating in bank purchase mode, and privately placed with SunTrust Bank (the Bank). As initially issued, the 2011 Bonds bear interest at a variable index interest rate which approximates 68% of 30-day London Inter-bank Offered Rate (LIBOR), plus 84 basis points.

The initial interest rate may be adjusted due to changes in the maximum individual federal income tax rate, and other regulatory changes affecting the cost of the loan to the Bank. On September 22, 2015, the Bank notified Orlando Health and the trustee that it elected not to tender the bonds on the scheduled mandatory purchase date in September 2016, and the next mandatory purchase date will be the first business day of June 2023. Upon mandatory tender for purchase, Orlando Health may convert to another available interest rate mode.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

7. Long-Term Debt (continued)

During the initial interest rate period, the 2011 Bonds are subject to optional redemption at the direction of Orlando Health at par on each interest payment date. Interest is payable monthly.

Capital Lease Obligations

Capital lease obligations account for approximately \$23,736,000 and \$24,837,000 of Capital lease obligations and other notes at September 30, 2018 and 2017, respectively. During 2017, the System recognized a capital lease commitment for a new ambulatory building.

Interest Rate Swap Agreements

In an effort to reduce costs of issuance and take advantage of low interest rates in effect at various times, Orlando Health has entered into interest rate swap arrangements that fix the interest rate on portions of variable rate bonds. The notional amounts under interest rate swap agreements hedging bonds are substantially the same as the principal maturities of the respective outstanding bond series. The construction loan swap hedged the majority of the construction loan at the maximum loan amount. Net interest receipts and payments are recognized as an adjustment to interest expense or as capitalized interest during periods of construction. The interest rate swap agreements are not accounted for under hedge accounting criteria. Therefore, changes in the value of these swaps are included in changes in fair value of interest rate swap agreements on the consolidated statements of operations and changes in net assets.

Collateral was required and posted on the 2011 swaps in the amount of approximately \$4,595,000 and \$14,258,000 at September 30, 2018 and 2017, respectively, and is included in the interest rate swap contract collateral in assets limited as to use.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

7. Long-Term Debt (continued)

The following summarizes outstanding swap positions as of September 30, 2018:

	2008E Swap	2011 Swaps
	<i>(Dollars in Thousands)</i>	
Initial notional amount	\$ 48,535	\$ 90,000
Notional amount at September 30, 2018	\$ 48,535	\$ 90,000
Current bond or loan hedged	2008E Bonds	2011 Bonds
Original bond or loan hedged	2006A Bonds	2007A1A2 Bonds
Maturity date	10/1/2026	10/1/2041
Fixed rate paid	3.57%	3.86%
Floating rate received	68% 30-day USD-LIBOR-BBA	68% 30-day USD-LIBOR-BBA

The following summarizes swap liability positions held during each year recorded within other noncurrent liabilities in the accompanying consolidated balance sheets:

	2008E Swap	2011 Swap	Total
	<i>(In Thousands)</i>		
Cumulative position at September 30, 2016	\$ (8,247)	\$ (42,964)	\$ (51,211)
Net gains during the year ended September 30, 2017	2,889	12,405	15,294
Cumulative position at September 30, 2017	(5,358)	(30,559)	(35,917)
Net gains during the year ended September 30, 2018	2,016	8,163	10,179
Cumulative position at September 30, 2018	\$ (3,342)	\$ (22,396)	\$ (25,738)

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

7. Long-Term Debt (continued)

Interest Costs

During periods of construction, interest costs on construction borrowings are capitalized to the respective property accounts. Capitalized interest is reduced by earnings on the investments held by the bond trustee for construction. Capitalized interest costs amounted to approximately \$1,369,000 and \$1,016,000 for the years ended September 30, 2018 and 2017, respectively. The total of interest cost expensed and capitalized approximates interest paid.

Fair Value

The estimated fair value of the System's long-term debt was approximately \$1,311,343 and \$1,014,104 at September 30, 2018 and 2017, respectively. This estimate is based on market quotes and based on current market rates available to the System and is categorized as having Level 2 valuation inputs as established by the FASB's fair value framework. The market quotes obtained from independent sources are within the range of management's expectations. The following tables provide information about long-term debt.

At September 30, 2018, the fair values are as follows:

	Fair Value	Carrying Value
	<i>(In Thousands)</i>	
Fixed rate hospital revenue bonds – secured	\$ 1,149,471	\$ 1,161,371
Variable rate hospital revenue bonds – secured	131,710	131,290
Notes payable and other indebtedness	30,162	30,162
	<u>\$ 1,311,343</u>	<u>\$ 1,322,823</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

7. Long-Term Debt (continued)

At September 30, 2017, the fair values are as follows:

	<u>Fair Value</u>	<u>Carrying Value</u>
	<i>(In Thousands)</i>	
Fixed rate hospital revenue bonds – secured	\$ 843,920	\$ 817,845
Variable rate hospital revenue bonds – secured	133,215	132,765
Notes payable and other indebtedness	36,969	32,082
	<u>\$ 1,014,104</u>	<u>\$ 982,692</u>

8. Lines of Credit

During the year ended September 30, 2015, a line of credit of \$4,500,000 was provided by a local bank to OHRI, LLC, a Controlled Affiliate, of which the System guarantees 51%. Interest on the line of credit is variable based on the Bank's prime rate. The loan matures and is due March 2, 2019. As of September 30, 2018, \$4,072,000 of the line had been drawn and is classified as other current liabilities.

9. Employee Retirement Plans

The System has defined contribution retirement plans. Certain employees of the System are eligible to participate in 401(a) and 403(b) plans, and certain PAL employees are eligible to participate in a 401(k) plan. Most plan participants may elect to contribute up to the lesser of \$18,500 or 50% of their annual compensation. For most plan participants, upon completion of one year of continuous service and having worked 1,000 hours or more, the System contributes 1.25% of the participants' compensation plus 50% of the participants' contributions up to 3% of the participants' compensation. The System's expense under the employee retirement plans amounted to approximately \$43,771,000, with \$14,561,000 attributed to LRHS, and \$28,059,000 for the years ended September 30, 2018 and 2017, respectively.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

9. Employee Retirement Plans (continued)

The System maintains deferred compensation plans for key management or highly compensated employees. The plans are intended to be nonqualified and unfunded and provide for the deferral of salary as well as additional discretionary system matching contributions. In 2017, the System revised its accounting for its 457(b) and 409(a) deferred compensation plans resulting in an increase in other assets and other noncurrent liabilities in the amounts of approximately \$16,800,000 and \$4,900,000, respectively, as of the beginning of the year. These amounts were not previously recognized in the consolidated balance sheet, and management believes the impact of such revision is immaterial.

10. Malpractice Insurance

The System is self-insured for medical malpractice risk not covered under a commercial malpractice policy. Losses are accrued based on estimates provided by an independent actuary, and are based on actuarial assumptions that incorporate the System's past experience and other considerations, including the nature of each claim or incident, and relevant trends. The accrued liability for self-insured claims amounted to approximately \$137,160,000 and \$131,472,000 at September 30, 2018 and 2017, respectively, of which approximately \$27,432,000 and \$26,294,000 are included in other current liabilities. The System has on deposit, in a revocable trust, cash and investments totaling approximately \$13,304,000 and \$13,428,000 at September 30, 2018 and 2017, respectively, to be used for the payment of self-insured claims in the future. The System does not have any claims that are discounted.

For claims occurring after April 1, 2012, Health Central is covered under the System's medical malpractice policy and self-insured malpractice fund. Any liabilities associated with the operations of Health Central subsequent to April 1, 2012, are included in the amounts noted above. The West Orange Healthcare District (District) has retained the medical malpractice liability for Health Central events occurring prior to closing of the Health Central transaction. The District is a governmental entity and is protected to a large extent by sovereign immunity protection against liability claims. The System is not liable for any Health Central-related events occurring prior to April 1, 2012.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

11. Commitments

The System leases equipment and space under operating leases with various lease terms. Aggregate future minimum lease payments, anticipated future lease payments on optional renewals, and estimated variable costs under these leases total approximately \$133,403,000 and are payable during the following years ending September 30: approximately \$21,639,000 in 2019, \$22,355,000 in 2020, \$23,030,000 in 2021, \$23,967,000 in 2022, \$24,870,000 in 2023, and \$17,542,000 thereafter.

On March 18, 2015, Orlando Health entered into an agreement to purchase a medical office building for approximately \$6,538,000, of which \$538,000 was paid on March 20, 2015. The transaction is not expected to close until May 1, 2019, at which time, the remaining approximately \$6,000,000 will be paid.

12. Business Combination

Lakeland Regional Health Systems, Inc.

Effective October 1, 2017, the System completed a transaction with LRHS to create an integrated regional health care system. The System obtained control through a member substitution arrangement whereby the System became the sole corporate member of LRHS without the transfer of consideration. The transaction was accounted for using the acquisition method of accounting.

During 2018, the System recorded the LRHS assets acquired and liabilities assumed at fair value and recognized an inherent contribution associated with business combination of approximately \$558,699,000. Effective September 30, 2018 the System and LRHS agreed to terminate their strategic relationship and LRHS provided financial and strategic concessions to terminate the relationship. Upon termination of the strategic relationship, the System deconsolidated the LRHS assets and liabilities at their net book values and recognized an inherent distribution from deconsolidation of business combination of approximately \$585,952,000.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

12. Business Combination (continued)

In accordance with ASC 958-805, the System recognized an inherent contribution as the excess of the acquisition date fair values of the assets acquired and liabilities assumed over the consideration transferred. The fair values assigned are summarized as follows:

Consideration transferred	\$	–
Fair values of assets acquired and liabilities assumed:		
Cash and investments		458,104
Patient accounts receivable		118,381
Other current assets		110,359
Property and equipment		601,820
Other noncurrent assets		46,268
Accounts payable and other current liabilities		(96,039)
Long-term debt		(647,716)
Other liabilities		(32,478)
Inherent contribution	\$	<u>558,699</u>
Classification of inherent contribution:		
Unrestricted	\$	526,815
Temporarily restricted		30,346
Permanently restricted		1,538
	\$	<u>558,699</u>
Classification of inherent distribution:		
Unrestricted	\$	548,685
Temporarily restricted		35,729
Permanently restricted		1,538
	\$	<u>585,952</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

12. Business Combination (continued)

The System used valuation techniques to determine the fair value of real and personal property (property and equipment), lease liability and long-term debt (long-term debt). Acquired land was valued using the sales comparison approach which relied on recent market transactions of similar tracts of land adjusted for individual characteristics. Other real and personal property were valued using the cost approach which relied on market data for similar assets. The lease liability was valued using the income approach which relied on scheduled future cash payments expected in future periods. Long-term debt was valued based on market quotes based on current market rates available to the System.

The following table summarizes amounts attributable to the System from the acquisition date through September 30, 2018, that are included in the accompanying 2018 consolidated statement of operations and changes in net assets:

Total unrestricted revenues and other support	\$ 775,841
Total expenses	<u>766,328</u>
Income from operations	9,513
Non-operating losses, net	<u>(10,427)</u>
Deficit of revenues, other support, and gains over expenses and losses	<u>\$ (914)</u>
Change in net assets:	
Unrestricted net assets	\$ (914)
Temporarily restricted net assets	-
Permanently restricted net assets	-
Total change in net assets	<u>\$ (914)</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2018

12. Business Combination (continued)

For the prior fiscal year, assuming the acquisition had taken place on October 1, 2016, the following table summarizes the fiscal year 2017 consolidated statement of operations and changes in net assets:

Total unrestricted revenues and other support	\$ 3,436,870
Total expenses	<u>3,190,478</u>
Income from operations	246,392
Non-operating gains, net	<u>149,761</u>
Excess of revenue, other support, and gains over expenses and losses	<u>\$ 396,153</u>
Change in net assets:	
Unrestricted net assets	\$ 415,675
Temporarily restricted net assets	(7,919)
Permanently restricted net assets	<u>(1,114)</u>
Total change in net assets	<u>\$ 406,642</u>

13. Subsequent Events

In preparing these consolidated financial statements, the System has evaluated events and transactions for potential recognition and disclosure through January 22, 2019, the date the consolidated financial statements were available to be issued.

Effective September 28, 2018, Orlando Health, South Lake, South Lake Memorial Hospital, Inc. and Live Well Foundation of South Lake, Inc. (Live Well) entered into a Contribution, Capital Investment and Services Agreement whereby Orlando Health would become the sole member of South Lake upon the closing date, which is contingent upon the establishment of Live Well as a tax-exempt entity. Live Well filed an application for tax-exempt status on November 13, 2018.

Supplementary Information

Orlando Health, Inc. and Controlled Affiliates

Consolidating Balance Sheet (In Thousands)

September 30, 2018

	Consolidated	Eliminations	Controlled Affiliates	Combined Obligated Group	Obligated Group Eliminations	Orlando Health Obligated Group Component	Orlando Health Central Obligated Group Component
Assets							
Current assets:							
Cash and cash equivalents	\$ 563,428	\$ —	\$ 20,326	\$ 543,102	\$ —	\$ 533,207	\$ 9,895
Assets limited as to use	34,062	—	—	34,062	—	34,062	—
Accounts receivable, net	350,082	—	29,414	320,668	—	291,030	29,638
Other receivables	64,415	(46,541)	15,033	95,923	(17,086)	74,764	38,245
Inventory	55,135	—	2,295	52,840	—	51,878	962
Other current assets	41,872	—	520	41,352	—	37,581	3,771
Total current assets	1,108,994	(46,541)	67,588	1,087,947	(17,086)	1,022,522	82,511
Assets limited as to use:							
Debt service and reserve funds held by bond trustee	19,227	—	—	19,227	—	16,163	3,064
Interest rate swap contract collateral receivable	4,595	—	—	4,595	—	4,595	—
Malpractice self-insurance	13,304	—	—	13,304	—	13,304	—
	37,126	—	—	37,126	—	34,062	3,064
Less amount required to meet current obligation	(34,062)	—	—	(34,062)	—	(34,062)	—
	3,064	—	—	3,064	—	—	3,064
Long-term investments – unrestricted	1,635,560	—	—	1,635,560	—	1,573,960	61,600
Long-term investments – restricted	117,932	—	117,932	—	—	—	—
Investments in related parties	41,867	(61,841)	89,477	14,231	—	14,231	—
Other assets	228,478	(139,498)	107,182	260,794	—	245,373	15,421
Property and equipment, net	1,465,550	—	35,671	1,429,879	—	1,169,772	260,107
Total assets	\$ 4,601,445	\$ (247,880)	\$ 417,850	\$ 4,431,475	\$ (17,086)	\$ 4,025,858	\$ 422,703
Liabilities and net assets							
Current liabilities:							
Accounts payable and accrued expenses	\$ 291,121	\$ —	\$ 33,558	\$ 257,563	\$ —	\$ 242,522	\$ 15,041
Other current liabilities	174,469	(43,321)	52,751	165,039	(17,086)	149,122	33,003
Current portion of long-term debt	22,152	—	1,486	20,666	—	20,666	—
Total current liabilities	487,742	(43,321)	87,795	443,268	(17,086)	412,310	48,044
Long-term debt, less current portion	1,300,671	—	4,733	1,295,938	—	1,152,229	143,709
Accrued malpractice claims	109,728	—	—	109,728	—	109,728	—
Other noncurrent liabilities	108,439	(38,801)	64,514	82,726	—	82,566	160
Total liabilities	2,006,580	(82,122)	157,042	1,931,660	(17,086)	1,756,833	191,913
Net assets							
Unrestricted:							
Orlando Health, Inc. and Controlled Affiliates	2,469,235	(61,841)	146,320	2,384,756	—	2,169,812	214,944
Noncontrolling interests in Controlled Affiliates	(440)	—	(440)	—	—	—	—
Total unrestricted	2,468,795	(61,841)	145,880	2,384,756	—	2,169,812	214,944
Temporarily restricted	124,625	(102,859)	113,243	114,241	—	98,395	15,846
Permanently restricted	1,445	(1,058)	1,685	818	—	818	—
Total net assets	2,594,865	(165,758)	260,808	2,499,815	—	2,269,025	230,790
Total liabilities and net assets	\$ 4,601,445	\$ (247,880)	\$ 417,850	\$ 4,431,475	\$ (17,086)	\$ 4,025,858	\$ 422,703

Orlando Health, Inc. and Controlled Affiliates

Consolidating Statement of Operations (In Thousands)

Year Ended September 30, 2018

	Consolidated	Eliminations	Controlled Affiliates	Combined Obligated Group	Obligated Group Eliminations	Orlando Health Obligated Group Component	Orlando Health Central Obligated Group Component
Unrestricted revenues and other support							
Net patient service revenue (net of contractual allowances and discounts)	\$ 4,054,219	\$ –	\$ 1,232,051	\$ 2,822,168	\$ –	\$ 2,553,192	\$ 268,976
Provision for bad debts	(421,614)	–	(133,483)	(288,131)	–	(232,611)	(55,520)
Net patient service revenue less provision for bad debts	3,632,605	–	1,098,568	2,534,037	–	2,320,581	213,456
Other revenue	174,483	(67,824)	84,458	157,849	(2,305)	154,356	5,798
Net assets released from restrictions	5,872	(14,075)	14,359	5,588	–	5,588	–
Total unrestricted revenues and other support	3,812,960	(81,899)	1,197,385	2,697,474	(2,305)	2,480,525	219,254
Expenses							
Salaries and benefits	1,945,932	–	858,221	1,087,711	–	978,082	109,629
Supplies and other	1,236,391	(75,960)	384,874	927,477	(2,305)	856,933	72,849
Professional fees	44,682	(7,490)	16,166	36,006	–	32,595	3,411
Depreciation and amortization	196,298	–	69,366	126,932	–	112,630	14,302
Interest	59,694	–	11,105	48,589	–	44,720	3,869
Total expenses	3,482,997	(83,450)	1,339,732	2,226,715	(2,305)	2,024,960	204,060
Income (loss) from operations	329,963	1,551	(142,347)	470,759	–	455,565	15,194
Nonoperating gains and losses							
Investment income	71,956	–	16,157	55,799	–	52,699	3,100
Change in fair value of interest rate swap agreements	10,179	–	–	10,179	–	10,179	–
Inherent contribution associated with business combination	526,815	–	526,815	–	–	–	–
Inherent distribution from deconsolidation of business combination	(548,685)	–	(548,685)	–	–	–	–
Nonoperating gain	2,976	–	(4,511)	7,487	–	6,294	1,193
Loss on early extinguishment of debt	(4,707)	–	–	(4,707)	–	(4,707)	–
Nonoperating gains, net	58,534	–	(10,224)	68,758	–	64,465	4,293
Excess (deficiency) of revenues, other support, and gains over expenses and losses	\$ 388,497	\$ 1,551	\$ (152,571)	\$ 539,517	\$ –	\$ 520,030	\$ 19,487

Orlando Health, Inc. and Controlled Affiliates

Orlando Health Central, Inc. Consolidating Balance Sheet
(In Thousands)

September 30, 2018

	Orlando Health Central	Health Central	Health Central Park	Other Non- Hospital Health Services
Assets				
Current assets:				
Cash and cash equivalents	\$ 9,855	\$ 5,192	\$ 4,703	\$ (40)
Accounts receivable, net	29,638	27,355	2,283	–
Other receivables	38,243	38,214	31	(2)
Inventory	962	962	–	–
Other current assets	3,774	3,737	34	3
Total current assets	82,472	75,460	7,051	(39)
Long-term investments – unrestricted	61,600	61,600	–	–
Other assets	18,485	18,485	–	–
Property and equipment, net	260,107	251,804	8,303	–
Total assets	\$ 422,664	\$ 407,349	\$ 15,354	\$ (39)
Liabilities and net assets				
Current liabilities:				
Accounts payable and accrued expenses	\$ 15,255	\$ 13,583	\$ 1,463	\$ 209
Other current liabilities	33,002	32,909	93	–
Total current liabilities	48,257	46,492	1,556	209
Long-term debt, less current portion	143,709	143,709	–	–
Other noncurrent liabilities	160	160	–	–
Total liabilities	192,126	190,361	1,556	209
Net assets:				
Unrestricted	214,692	201,243	13,697	(248)
Temporarily restricted	15,846	15,745	101	–
Total net assets	230,538	216,988	13,798	(248)
Total liabilities and net assets	\$ 422,664	\$ 407,349	\$ 15,354	\$ (39)

Orlando Health, Inc. and Controlled Affiliates

Orlando Health Central, Inc. Consolidating Statement of Operations
(In Thousands)

Year Ended September 30, 2018

	Orlando Health Central	Health Central	Health Central park	Other Non- Hospital Health Services
Unrestricted revenues and other support				
Net patient service revenue (net of contractual allowances and discounts)	\$ 272,701	\$ 239,184	\$ 22,478	\$ 11,039
Provision for bad debts	(55,399)	(54,135)	(854)	(410)
Net patient service revenue less provision for bad debts	217,302	185,049	21,624	10,629
Other revenue	6,072	5,140	116	816
Total unrestricted revenues and other support	223,374	190,189	21,740	11,445
Expenses				
Salaries and benefits	112,941	94,869	13,309	4,763
Supplies and other	74,883	62,382	6,963	5,538
Professional fees	3,583	3,553	29	1
Depreciation and amortization	14,446	13,064	409	973
Interest	3,869	3,869	-	-
Total expenses	209,722	177,737	20,710	11,275
Income from operations	13,652	12,452	1,030	170
Nonoperating gains				
Investment income	3,100	3,100	-	-
Nonoperating gain	1,182	-	-	1,182
Nonoperating gains, net	4,282	3,100	-	1,182
Excess of revenues other support, and gains over expenses and losses	\$ 17,934	\$ 15,552	\$ 1,030	\$ 1,352

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2018 Ernst & Young LLP.
All Rights Reserved.

ey.com

