

CONSOLIDATED FINANCIAL STATEMENTS

Premier Health Partners and Subsidiaries
Years Ended December 31, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Premier Health Partners and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2018 and 2017

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Report of Independent Auditors

The Board of Trustees
Premier Health Partners and Subsidiaries

We have audited the accompanying consolidated financial statements of Premier Health Partners and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 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 consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Premier Health Partners and Subsidiaries at December 31, 2018 and 2017, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Changes in Accounting Principles

As discussed in Note A to the consolidated financial statements, in 2018 Premier Health Partners and Subsidiaries changed its method for revenue recognition as a result of the adoption of Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)* and changed its method of financial statement presentation as a result of the adoption of ASU 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities*. Our opinion is not modified with respect to these matters.



March 14, 2019

Premier Health Partners and Subsidiaries

Consolidated Balance Sheets

(Dollars in Thousands)

	December 31	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 87,945	\$ 55,681
Patient accounts receivable	256,427	272,880
Inventories	15,294	16,143
Prepaid expenses	23,710	20,996
Estimated receivable from third-parties	7,508	961
Assets to be disposed other than by sale (Note A)	12,917	37,635
Other current assets	16,413	21,103
Total current assets	<u>420,214</u>	<u>425,399</u>
Assets limited as to use: (Note D)		
Board-designated investments	865,151	1,125,097
Other investments	116,635	135,472
Total assets limited as to use	<u>981,786</u>	<u>1,260,569</u>
Property and equipment, net (Note F)	1,060,466	987,235
Intangible assets, net (Note M)	34,321	30,777
Other assets	129,566	138,720
Total assets	<u>\$ 2,626,353</u>	<u>\$ 2,842,700</u>

Premier Health Partners and Subsidiaries

Consolidated Balance Sheets (continued)

(Dollars in Thousands)

	December 31	
	2018	2017
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 103,470	\$ 61,459
Accrued expenses	91,156	92,958
Current portion of long-term debt (Note H)	13,723	14,116
Estimated payable to third-parties	4,685	2,482
Liabilities to be disposed other than by sale (Note A)	4,382	22,133
Other current liabilities	38,798	35,824
Total current liabilities	<u>256,214</u>	<u>228,972</u>
Long-term debt, less current portion (Note H)	911,929	922,884
Pension obligation (Note I)	81,664	34,271
Reserve for professional liability (Note G)	37,810	43,591
Interest rate swap liability (Note J)	32,302	42,714
Other liabilities	102,696	107,761
Total liabilities	<u>1,422,615</u>	<u>1,380,193</u>
Net assets:		
Without donor restrictions	1,142,365	1,399,665
With donor restrictions	61,373	62,842
Total net assets	<u>1,203,738</u>	<u>1,462,507</u>
Total liabilities and net assets	<u>\$ 2,626,353</u>	<u>\$ 2,842,700</u>

See accompanying notes.

Premier Health Partners and Subsidiaries

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

	Year Ended December 31	
	2018	2017
Operating revenue		
Patient service revenue	\$ 1,724,781	\$ 1,650,427
Other operating revenue	80,226	88,517
Total operating revenue	<u>1,805,007</u>	<u>1,738,944</u>
Operating expenses		
Salaries and wages	912,509	853,825
Employee benefits	181,747	172,431
Supplies	315,046	302,398
Purchased services, insurance and other	337,016	333,195
Hospital franchise tax	25,082	24,726
Depreciation and amortization	134,622	144,452
Interest	30,600	28,939
Total operating expenses	<u>1,936,622</u>	<u>1,859,966</u>
Loss from operations before exit, disposal, impairment and other costs	(131,615)	(121,022)
Exit, disposal, impairment and other costs (Note A)	(36,696)	(67,020)
Loss from operations	<u>(168,311)</u>	<u>(188,042)</u>
Non-operating (losses) gains, net (Note K)	<u>(44,831)</u>	133,456
Deficiency of revenue over expenses	(213,142)	(54,586)
Change in plan assets and benefit obligations of pension plans	(39,953)	(3,595)
Change in net assets with donor restrictions and other	(1,856)	7,082
Loss from discontinued operations (Note A)	(3,818)	(20,594)
Decrease in net assets	(258,769)	(71,693)
Net assets at beginning of year	<u>1,462,507</u>	1,534,200
Net assets at end of year	<u>\$ 1,203,738</u>	<u>\$ 1,462,507</u>

See accompanying notes.

Premier Health Partners and Subsidiaries

Consolidated Statements of Cash Flows

(Dollars in Thousands)

	Year Ended December 31	
	2018	2017
Operating activities		
Decrease in net assets	\$ (258,769)	\$ (71,693)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Loss from discontinued operations	3,818	20,594
Depreciation and amortization	134,622	144,452
Impairment of long-lived assets	6,366	66,036
Change in the valuation of swap agreements	(10,578)	(2,976)
Change in plan assets and benefit obligations of pension plans	39,953	3,595
Change in unrealized losses (gains) on assets limited as to use	73,004	(92,162)
Gains on disposal of assets	–	(230)
Loss on extinguishment of debt	232	–
Gains from alternative investments	7,518	(34,729)
Purchase of alternative investments	(55,349)	(70,278)
Distribution from alternative investments	58,450	86,972
Pension plan contribution	(9,100)	(36,000)
Net change in assets and liabilities:		
Accounts receivable	16,453	16,572
Assets limited as to use	195,160	67,287
Other assets	2,486	(33,556)
Accounts payable and other accruals	33,580	132
Estimated receivable/payable with third-parties	(4,344)	11,695
Pension plan liability	16,540	12,128
Other liabilities	(7,763)	9,233
Net cash provided by continuing operations	242,279	97,072
Net cash provided by (used in) discontinued operations	3,149	(20,697)
Net cash provided by operating activities	245,428	76,375
Investing activities		
Proceeds from the sale of assets	3,251	4,405
Purchases of property and equipment	(205,096)	(106,004)
Net cash used in investing activities	(201,845)	(101,599)
Financing activities		
Proceeds from refinancing long-term debt	58,505	15,000
Interest rate swap collateral	4,130	(5,650)
Extinguishment of long-term debt relating to refinancing	(58,505)	(15,000)
Repayment of long-term debt and capital leases	(15,449)	(17,780)
Net cash used in financing activities	(11,319)	(23,430)
Increase (decrease) in cash and cash equivalents	32,264	(48,654)
Cash and cash equivalents at beginning of year	55,681	104,335
Cash and cash equivalents at end of year	\$ 87,945	\$ 55,681

See accompanying notes.

Premier Health Partners and Subsidiaries
Notes to Consolidated Financial Statements

December 31, 2018

A. Organization and Significant Accounting Policies

Organization

On January 1, 2018, MedAmerica Health Systems (MAHS), Catholic Health Initiatives (CHI), Atrium Health System (AHS) and Upper Valley Medical Center Parent and Controlled Affiliates (UVMC Parent) (collectively and altogether, the Parent Organizations) contributed nearly all of their interests in their respective affiliates, subsidiaries and other assets to Premier Health Partners (PHP), a not-for-profit organization in accordance with the Definitive System Reorganization Agreement (DSRM). Prior to this date, PHP was organized and operated under a Joint Operating Agreement (JOA) and financial statements were presented on a combined basis. The reorganization under the DSRM constitutes a change in reporting entity under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 250, *Accounting Changes and Error Corrections*. As a result, comparative financial statements have been prepared on a consolidated basis. Pursuant to the DSRM, the Parent Organizations became the member organizations of PHP.

PHP owns and operates organizations that provide healthcare services and support to communities in Southwest Ohio, including:

- Miami Valley Hospital (MVH),
- Good Samaritan Hospital (GSH), including wholly owned Heart Institute of Dayton (HID) and wholly owned Samaritan North Surgery Center, Ltd. (SNSC),
- Atrium Medical Center (AMC), including wholly owned Southwest Surgery Center (SWSC) and Middletown Surgery Center, LLC, dba Bidwell Surgery Center (BSC),
- Upper Valley Medical Center (UVMC),
- Fidelity Health Care (FHC),
- Premier Community Health (PCH),
- Samaritan Health Partners (SHP) and its wholly owned subsidiary Samaritan Behavioral Health Incorporated (SBHI),
- Premier Health Holding Company (PHHC) which owns Premier Health Specialists, Inc. (PHS), MVHE, Inc., Samaritan Family Care (SFC) and Premier Health Urgent Cares,
- UVMC Nursing Care Incorporated (UVNC),

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

- Upper Valley Professional Corporation (UVPC),
- After Hours Family Care Incorporated (AHFC), and
- UVPC Specialists Incorporated (UVPCSI)

Organizations owned and operated by PHP that support the mission of the healthcare services include: Premier Health International Insurance Limited (PHIIL); Miami Valley Hospital Foundation (MVHF); Good Samaritan Hospital Foundation (GSHF); Premier Health Group, LLC (PHG); Premier Health Accountable Care Organization (ACO) of Ohio (PHACO) (disposed of on December 31, 2017) and UVMC Management Corporation (UVMCMC).

PHP owns insurance companies including Premier Health Insuring Corporation (PHIC) and Premier Health Plan, LLC (PHPlan). PHP also controls and consolidates Premier Plaza, LLC.

Certain entities are financially interrelated to PHP. These entities include: Atrium Medical Center Foundation (AMCF), UVMC Foundation (UVMCF) and certain assets of UVMC Parent.

Principles of Consolidation

The financial statements of PHP have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The consolidated financial statements of PHP include the accounts of PHP and its controlled entities. Joint ventures at the consolidated level of PHP greater than 50% are consolidated in the PHP financial statements. Joint ventures that are 50% or less at the consolidated level of PHP are not consolidated in the PHP financial statements. These investments are accounted for using the equity method of accounting and are included in other assets on the consolidated balance sheets. The consolidated financial statements also include the entities for which management has determined are financially interrelated entities. All material intercompany accounts and transactions are eliminated between affiliates upon combination of the PHP consolidated financial statements.

Net Assets Without Donor Restrictions

Net assets that are not subject to donor-imposed restrictions may be expended for any purpose in performing the primary objectives of the organization. These net assets may be used at the discretion of PHP's management and the board of trustees.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

Net Assets With Donor Restrictions

Net assets with donor restrictions consists of those assets whose use has been restricted by donors. Some restrictions are temporary in nature, meaning those resources can only be used after a specified date, for a particular program or service or to acquire buildings or equipment. Other restrictions require that PHP maintain resources in perpetuity. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, the associated net assets are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations and changes in net assets. Donor restricted net assets that have met their restriction and the income from donor restricted net assets are used primarily to support health care services and capital needs.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the revenue and expenses of the periods reported. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Claims and Contingencies

In the normal course of business, PHP is subject to various lawsuits, actions, proceedings, claims, and other matters asserted under laws and regulations. Management believes the amounts recorded in its consolidated financial statements are adequate in light of the probable and estimable contingencies. However, there can be no assurances that the actual amounts required to satisfy alleged liabilities from various legal proceedings, claims, and other matters and to comply with applicable laws and regulations will not exceed the amounts reflected in its consolidated financial statements and, therefore, it is possible that recorded estimates may change by a material amount.

Cash and Cash Equivalents

PHP considers all highly liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents, excluding the short-term investments within assets limited as to use.

Patient Accounts Receivable and Patient Service Revenue

Patient accounts receivable and patient service revenue have been adjusted to the estimated amounts expected to be collected.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

PHP has agreements with third-party payors that provide for payments at amounts different from its established rates. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement, negotiated discounts from established rates, and per diem payments. Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to future audits, reviews, and investigations. The differences between the estimated and actual adjustments are recorded as part of patient service revenue in future periods, as the amounts become known or as years are no longer subject to such audits, reviews and investigations.

For uninsured patients who do not qualify for charity care, PHP recognizes revenue based on established rates, subject to certain discounts as determined by PHP. The estimated uncollectable amounts due from these patients are generally considered implicit price concessions that are a direct reduction to patient service revenues and are being reported at the net amount expected to be received in the consolidated statements of operations and changes in net assets.

Inventories

Inventories, carried at average cost, include pharmacy and other medical supplies that are used in the hospital operations.

Fair Value Measurements

PHP follows the provisions of FASB ASC 820, *Fair Value Measurements*, which defines fair value as 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 and establishes a framework for measuring fair value. ASC 820 defines a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, and as noted above, ASC 820 defines a three-level fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity and the reporting entity's own assumptions about market participants. The fair value hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs utilize quoted market prices in active markets for identical assets or liabilities.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

- Level 2 – Inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset and liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.
- Level 3 – Inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level of input that is significant to the fair value measurement in its entirety. PHP's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

In order to meet the requirements of ASC 820, PHP uses three basic valuation approaches to determine the fair value of its assets and liabilities required to be recorded at fair value. The first approach is the cost approach. The cost approach is generally the value a market participant would expect to pay to replace the respective asset or liability. The second approach is the market approach, which looks at how a market participant would value an exact or similar asset or liability to that of PHP, including those traded on exchanges. The third approach is the income approach. The income approach uses estimation techniques to determine the estimated future cash flows of PHP's respective asset or liability expected by a market participant and discounts those cash flows back to present value (more typically referred to as a discounted cash flow approach).

Assets Limited as to Use

Assets limited as to use consist of Board-designated and other investments, which are used to support capital and operating needs of the organization. Investments consist of cash and short-term investments, equity securities, mutual funds, common trust funds, corporate and other bonds, U.S. government securities, and alternative investments in limited liability companies, hedge funds, and private equities.

PHP has elected to account for common trust funds at fair value as allowed under ASC 825, *Financial Instruments*, due to the nature of these investments and their similarity to exchange-traded mutual funds.

The carrying value of limited liability companies, hedge funds, and private equities, collectively alternative investments, are based on valuations provided by the administrators of the specific financial instruments. Alternative investments are accounted for using the equity method of accounting based on the net asset value (NAV) provided by the administrators. The underlying investments in these financial instruments

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

may include marketable debt and equity securities, commodities, foreign currencies, derivatives, and private equity investments. The underlying investments are subject to various risks including market, credit, liquidity, and foreign exchange risk. PHP believes the carrying amount of these financial instruments in the consolidated balance sheets is a reasonable estimate of its ownership interest in the alternative investments. Because some of these financial instruments are not readily marketable, the estimated carrying value is subject to uncertainty, and therefore, may differ from the value that would have been used had a public market for such financial instruments existed. Such differences could be material. PHP's risk related to alternative investments is limited to its carrying value plus amounts committed to private equity as disclosed in Note D.

Some of PHP's alternative investments have liquidity restrictions, meaning amounts can be divested only at specific times based on the terms of the respective partnership agreements. Certain general resources are designated by the governing board for capital and other expenditures or are limited under the terms of the bond indenture and are reported as other investments on the consolidated balance sheets.

Gains and losses consist of realized gains and losses on the sale of investments, the market valuation changes in investments, as well as dividend and interest income. These gains and losses are included in the deficiency of revenue over expenses unless the income or loss is restricted by donor or law. Investment income or loss that is restricted by donor or law is included in the changes in net assets with donor restrictions, as appropriate. Changes in unrealized gains and losses on investments that have been designated as trading securities are also included in the deficiency of revenue over expenses as investment income or loss.

The global financial markets and the banking system are subject to volatility, which could adversely affect PHP. Certain PHP assets and liabilities are exposed to various risks such as interest rate, market, and credit risks.

PHP's collective investment program include trust assets relating to its self-insurance program for professional liability claims. These trust assets provide funds for professional liability claims under a self-insurance program and are reported as an asset limited as to use.

Property and Equipment

Property and equipment are stated at historical cost or, if donated, fair value at the date of receipt. Depreciation and amortization are calculated on a straight-line basis over the estimated asset lives. Depreciation taken on assets recorded as capital leases is determined over the shorter of the period of the lease term or the useful life of the underlying asset and is included as a component of accumulated depreciation and depreciation expense in the consolidated balance sheets and consolidated statements of

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

operations and changes in net assets, respectively. Interest on construction-in-process is capitalized and amortized over the estimated lives of the related depreciable assets. Depreciation expense was \$132.8 million and \$143.1 million for the years ended December 31, 2018 and 2017, respectively, and is included in depreciation and amortization expense in the consolidated statements of operations and changes in net assets.

PHP evaluates the carrying value of long-lived assets, including property and equipment, and the related estimated remaining lives when events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed. PHP may evaluate its business operations from time to time and determine that certain organization changes are required to meet the future strategic goals of PHP. Any resulting impairment losses or additional required depreciation due to shortened useful lives are recorded in the accompanying consolidated statements of operations and changes in net assets if those long-term assets are related to continuing operations.

Exit, Disposal, Impairment and Other Costs

Management continually evaluates its business and has implemented cost savings initiatives and reorganization efforts to react to changes affecting the business to better align its operations to its strategic plan. As such, in January 2018, management made the decision to close GSH. This decision required management to assess GSH and the surrounding campus for impairment at December 31, 2017. Management completed a test of recoverability and determined that the estimated future cash flows were less than the carrying value of GSH and surrounding campus, indicating impairment. Management engaged a third-party valuation firm to evaluate GSH and surrounding campus in accordance with ASC 820. The valuation indicated that the fair value of GSH and surrounding campus was impaired and an impairment loss of \$66.0 million was recorded for the year ended December 31, 2017. GSH was closed at the end of July 2018. For the year ended December 31, 2018, PHP recorded charges of \$29.1 million resulting from the GSH closure that included impairment of assets, retention costs, voluntary retirement costs and other associated costs. These amounts are reflected in the line Exit, Disposal, Impairment and Other Costs in the consolidated statements of operations and changes in net assets. PHP will complete the GSH project during 2019 when the buildings on the GSH campus are razed.

For the years ended December 31, 2018 and 2017, GSH's (deficiency) excess of revenue over expenses was (\$1.2) million and \$41.4 million, respectively.

During 2018, PHP also implemented other cost savings initiatives that resulted in exit, disposal and other costs of \$7.6 million that were not related to the GSH closure. These costs included one-time voluntary retirement costs, building demolition and contract termination costs. These amounts are reflected in Exit, Disposal, Impairment and Other Costs in the consolidated statements of operations and changes in net assets.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

Goodwill and Intangible Assets, Net

Intangible assets consist of goodwill and other identifiable intangible assets such as non-compete agreements. Definite-lived intangible assets are amortized using the straight-line method, which allocates the cost over the estimated useful lives of generally three to five years. Goodwill is tested annually for impairment. PHP performed its goodwill impairment test on October 1, 2018, its annual goodwill evaluation test date. The evaluation by management determined no events or circumstances existed to conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

Derivative Financial Instruments

PHP uses derivative financial instruments (interest rate swaps) in managing its capital costs. The interest rate swaps are recorded at fair market value based on the contractual terms, including the period to maturity, and observable market-based inputs are used to value the swaps (see Note J).

The net cost and change in fair value of such interest rate swaps is recognized as a component of non-operating gains in the consolidated statements of operations and changes in net assets. The interest rate swap agreements are exposed to counterparty risk, which is the risk that contractual obligations of the counterparty will not be fulfilled. Collateralization requirements mitigate some of the credit risk associated with PHP's interest rate swap agreements.

Pension

PHP utilizes an approach that discounts the individual expected cash flows underlying interest and service costs using the applicable spot rates derived from the yield curve used to determine the benefit obligation to the relevant projected cash flows. This method provides a more precise measurement of service and interest costs by improving the correlation between projected benefit cash flows and the corresponding spot yield curve rates. The use of disaggregated discount rates results in a different amount of weightings given to each subset of payments. The use of disaggregated discount rates affects the amount of service cost, because the benefit payments associated with new service credits for active employees tend to be of longer duration than the overall benefit payments associated with the plan's benefit obligation. As a result, the payments are associated with longer-term spot rates on the yield curve, resulting in lower present values than the calculations using the traditional single weighted-average discount rate.

Hospital Franchise Tax

The Ohio Hospital Franchise Fee program requires Ohio hospitals to pay a provider tax to the State in order to draw down federal Medicaid matching funds. For the years ended December 31, 2018 and 2017, PHP recorded as expense, \$25.1 million and \$24.7 million, respectively, for the hospital franchise tax.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

The upper payment limit (UPL) payments are recorded as other operating revenue. For the years ended December 31, 2018 and 2017, PHP recorded revenue related to UPL payments of \$33.0 million and \$29.9 million, respectively.

Functional Expenses

The consolidated financial statements report certain categories of expenses that are primarily attributable to providing health care services and supporting functions. Some expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include technology, office, occupancy and depreciation, which are allocated as a percentage of direct program costs to total operating costs. Salaries and benefits are allocated on the basis of estimates of time and effort. Expenses reported in the consolidated statements of operations and changes in net assets are as follows for the years ended December 31:

	2018			2017		
	<i>(Dollars in Thousands)</i>					
	Healthcare Services	Management and General	Total	Healthcare Services	Management and General	Total
Salaries and wages	\$ 814,158	\$ 98,351	\$ 912,509	\$ 770,465	\$ 83,360	\$ 853,825
Employee benefits	157,890	23,857	181,747	149,114	23,317	172,431
Supplies	314,044	1,002	315,046	301,470	928	302,398
Purchased services and other	314,945	22,071	337,016	291,912	41,283	333,195
Hospital franchise tax	25,082	–	25,082	24,726	–	24,726
Depreciation and amortization	132,935	1,687	134,622	142,189	2,263	144,452
Interest	30,600	–	30,600	28,939	–	28,939
Total operating expenses	<u>\$1,789,654</u>	<u>\$ 146,968</u>	<u>\$1,936,622</u>	<u>\$1,708,815</u>	<u>\$ 151,151</u>	<u>\$1,859,966</u>

Deficiency of Revenue Over Expenses

The consolidated statements of operations and changes in net assets include the line deficiency of revenue over expenses, which represents the performance indicator for PHP. Consistent with industry practice, changes in net assets that are excluded from the deficiency of revenue over expenses include change in plan assets and benefit obligations of pension plans, net gains (losses) on net assets with donor restrictions and other and discontinued operations.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

Income Taxes

PHP has been determined by the Internal Revenue Service to be a tax-exempt nonprofit corporation under Section 501(c)(3) of the Internal Revenue Code. As a tax-exempt organization, its income is exempt from federal income tax except to the extent of any unrelated business activities. PHP consolidates certain subsidiaries, which are for-profit corporations subject to federal income taxes. These are:

- PHIC and PHHC (wholly owned subsidiaries of PHP),
- PHPlan (a wholly owned subsidiary of PHIC),
- MVHE, Inc., Samaritan Family Care, Premier Health Specialists, Inc. and Premier Health Urgent Care (subsidiaries of PHHC),
- Samaritan North Surgery Center, Ltd. (a wholly owned subsidiary of GSH), and
- UVMC Management Corporation and After Hours Family Care, Inc. (subsidiaries of PHP).

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. For tax-exempt entities, the Act requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. Certain regulatory guidance provides for a measurement period of up to one year, during which the accounting for the tax effects of the Act may be completed. PHP may record further adjustments in future periods upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the date of enactment. PHP will continue to revise and refine the calculations as additional IRS guidance is issued; however, PHP does not anticipate any material impact to the consolidated financial statements.

Management annually reviews the tax positions and has determined that there are no material uncertain tax positions.

Discontinued Operations

During 2017, PHP made the decision to exit the Medicare and Commercial insurance companies PHIC and PHPlan, as well as its accountable care organization, PHACO. Based on ASC 205, *Discontinued Operations*, management determined that the assets and liabilities of PHIC and PHPlan should be reflected and disclosed in the consolidated financial statements as held for sale at December 31, 2017. Accordingly,

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

PHP reported the carrying amounts of the PHIC and PHPlan assets and liabilities at the lower of carrying value or fair value, less cost to sell at December 31, 2017. The assets for PHACO were disposed of other than by sale effective December 31, 2017. Since PHP did not complete a sale of PHIC and PHPlan during 2018 and made the decision to exit these businesses in 2018, the remaining assets and liabilities were disposed of other than by sale effective December 31, 2018; however, certain balances remained at December 31, 2018 and will do so until they are settled in connection with regulatory requirements.

Based on the criteria in ASC 205, *Discontinued Operations*, it was determined that the Medicare and Commercial insurance companies PHIC and PHPlan, as well as the accountable care organization, PHACO, met the criteria for discontinued operations treatment for the years ended December 31, 2018 and 2017 as the exit represented a strategic shift in PHP's business. Consequently, the results of operations for PHIC, PHPlan and PHACO have been classified as a single consolidated financial statement line within changes in net assets for all periods presented.

The following is a summary of assets and liabilities to be disposed of other than by sale related to PHIC and PHPlan at December 31:

	2018			2017		
	PHIC	PHPlan	Total	PHIC	PHPlan	Total
Cash and cash equivalents	\$ 3,881	\$ 6,312	\$ 10,193	\$ 8,946	\$ 9,847	\$ 18,793
Other current assets	1,223	586	1,809	3,616	4,235	7,851
Total current assets	5,104	6,898	12,002	12,562	14,082	26,644
Assets limited as to use:						
Other investments	460	455	915	10,542	449	10,991
Assets to be disposed of other than by sale	\$ 5,564	\$ 7,353	\$ 12,917	\$ 23,104	\$ 14,531	\$ 37,635
Reserve for medical expenses	\$ 250	\$ 467	\$ 717	\$ 10,041	\$ 4,253	\$ 14,294
Accounts payable and other accrued liabilities	2,795	870	3,665	5,288	2,551	7,839
Liabilities to be disposed of other than by sale	\$ 3,045	\$ 1,337	\$ 4,382	\$ 15,329	\$ 6,804	\$ 22,133

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

The following is a summary of the components of loss from discontinued operations for the years ended December 31:

	2018				2017			
	PHIC	PHPlan	PHACO	Total	PHIC	PHPlan	PHACO	Total
Revenues								
Premium revenue	\$22,012	\$ 4,154	\$ –	\$26,166	\$91,790	\$31,749	\$ –	\$123,539
Other operating revenue	–	60	2,792	2,852	–	6,663	300	6,963
Total revenue	22,012	4,214	2,792	29,018	91,790	38,412	300	130,502
Operating expenses								
Medical expenses	20,345	4,135	–	24,480	85,618	26,914	–	112,532
Purchased services and other	8,634	3,425	(311)	11,748	19,111	12,032	7,510	38,653
Total operating expenses	28,979	7,560	(311)	36,228	104,729	38,946	7,510	151,185
Operating margin	(6,967)	(3,346)	3,103	(7,210)	(12,939)	(534)	(7,210)	(20,683)
Investment income	79	6	47	132	74	3	12	89
Other income	1,630	1,630	–	3,260	–	–	–	–
Deficiency of revenue over expenses	\$ (5,258)	\$ (1,710)	\$ 3,150	\$ (3,818)	\$(12,865)	\$ (531)	\$ (7,198)	\$ (20,594)

Recently Adopted Accounting Standards

Effective December 31, 2018, PHP adopted FASB ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. This ASU changes certain financial statement requirements for not-for-profit entities in an effort to make the information more meaningful to users and reduced reporting complexity. PHP adopted the ASU and has adjusted the presentation in these consolidated financial statements accordingly.

Effective January 1, 2018, PHP adopted FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the full retrospective method of transition. This ASU converged and replaced existing revenue recognition guidance, including industry-specific guidance and requires revenue to be recognized in an amount that reflects the consideration the entity expects to be entitled in an exchange of goods or services. The adoption of this ASU did not result in changes to previously reported net revenue, other than presentation.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

A. Organization and Significant Accounting Policies (continued)

Pending Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. This ASU requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. The ASU will require disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. This ASU is effective for PHP beginning January 1, 2019 and will be applied using a modified retrospective approach. The primary effect of adopting the ASU will be to record right-of-use assets and obligations for current operating leases. PHP is currently evaluating the effect of adoption on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which changes how employers that sponsor defined benefit pension plans present the net periodic benefit cost in the statement of operations. ASU 2017-07 requires employers to present the service cost component of net periodic benefit cost in the same statement of operations line items as other employee compensation costs arising from services rendered during the period. Employers are to present the other components of net periodic benefit cost separately from the line items that include the service cost and outside of any subtotal of operating income, if one is presented. Employers will have to disclose the lines used to present the other components of net periodic benefit cost, if the components are not presented separately in the statement of operations. ASU 2017-07 is effective for fiscal years beginning after December 15, 2018, and interim periods therein. The guidance provides a practical expedient for disaggregating the service cost component and other components for comparative periods. PHP adopted ASU 2017-07 as of January 1, 2019 and will begin recording the separate components of net periodic pension cost in its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820)*. This ASU improves the disclosure requirements on fair value measurements and is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. PHP is currently evaluating the impact ASU 2018-13 will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, *Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20)*. This update clarifies specific requirements and adds disclosure requirements considered relevant to financial statement users of organizations that sponsor defined benefit pension plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2021, with early adoption permitted. PHP is currently evaluating the impact this update will have on its consolidated financial statements.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

B. Patient Service Revenue

Patient care service revenue is reported at the amount that reflects the consideration to which PHP expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, PHP bills the patients and third-party payors several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by PHP. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. PHP believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the hospital receiving inpatient acute care services. PHP measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and PHP does not believe it is required to provide additional goods or services to the patient.

Because all of its performance obligations relate to contracts with a duration of less than one year, PHP has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

PHP determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with PHP's policy, and/or implicit price concessions provided to uninsured patients. PHP determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policy, and historical experience. PHP determines its estimate of implicit price concessions based on its historical collection experience with each class of patients.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

- Medicare: Certain inpatient acute care services are paid at prospectively determined rates per discharge based on clinical, diagnostic and other factors. Certain services are paid based on cost-reimbursement methodologies subject to certain limits. Physician services are paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

B. Patient Service Revenue (continued)

- Medicaid: Reimbursements for Medicaid services are generally paid at prospectively determined rates per discharge, per occasion of service, or per covered member.
- Other: Payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge PHP's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon PHP.

In addition, the contracts PHP has with commercial payors also provide for retroactive audit and review of claims. Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and PHP's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as new information becomes available, or as years are settled or are no longer subject to such audits, reviews, and investigations. The effect of these settlements was recognition of net revenue of \$3.1 million and \$3.6 million in 2018 and 2017, respectively.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. PHP also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. PHP estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended December 31, 2018 and 2017, the changes to the estimates of implicit price concessions for performance obligations satisfied in prior years were not

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

B. Patient Service Revenue (continued)

significant. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense. Bad debt expense for the years ended December 31, 2018 and 2017 was not significant.

Consistent with PHP's mission, care is provided to patients regardless of their ability to pay. Therefore, PHP has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances such as copays and deductibles. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts PHP expects to collect based on its collection history with those patients. Patients who meet PHP's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue. The estimated cost incurred by PHP to provide these services to patients, based on a cost to charge ratio, who are unable to pay was \$37.8 million and \$47.0 million for the years ended December 31, 2018 and 2017, respectively.

PHP recorded charity care subsidies of \$16.3 million and \$19.2 million for the years ended December 31, 2018 and 2017, respectively, which were recognized as a component of patient service revenue in the consolidated statements of operations and changes in net assets. Charity care subsidies comprise the Ohio Hospital Care Assurance program and the Montgomery County Human Services Levy.

The composition of patient care service revenue by payor is as follows for the years ended December 31:

	2018	2017
	<i>(Dollars in Thousands)</i>	
Medicare	\$ 592,473	\$ 570,447
Medicaid	228,987	238,412
Commercial	880,843	818,688
Self-pay	22,478	22,880
	\$ 1,724,781	\$ 1,650,427

PHP has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to PHP's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, PHP does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

C. Financial Assets and Liquidity Availability

As of December 31, 2018, PHP had a working capital surplus of \$164.0 million.

Financial assets available for general expenditure within one year of the balance sheet date consist of the following:

Cash and cash equivalents	\$ 87,945
Patient accounts receivable	256,427
Assets limited as to use:	
Board-designated investments	804,301
Other investments	24,832
	<u>\$ 1,173,505</u>

PHP has certain board-designated and donor-restricted assets limited to use which are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above. PHP has other assets limited to use for donor-restricted purposes, debt service and for the professional and general liability captive insurance program. These assets limited to use, which are more fully described in Notes D and E are not available for general expenditure within the next year and are not reflected in the amounts above. As part of PHP's liquidity management plan, cash in excess of daily requirements are invested in short term investments and money market funds.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

D. Assets Limited as to Use

Assets limited as to use consist of the following as of December 31:

	2018	2017
	<i>(Dollars in Thousands)</i>	
Cash and short-term investments	\$ 14,755	\$ 22,407
Equity securities	35,575	51,652
Mutual funds:		
Domestic large cap	14,446	23,400
Domestic small cap	90	104
International	97,166	177,390
Fixed income	217,426	218,960
Common trust funds	128,906	191,092
Corporate and other bonds:		
Corporate and other bonds	16,901	17,472
Asset-backed securities	18,421	20,262
U.S. government securities:		
U.S. government securities	8,428	10,559
U.S. government agencies	5,417	5,056
Alternative investments:		
Limited liability companies	129,392	127,783
Hedge funds	52,963	76,649
Private equity ^(a)	55,455	40,611
Interest in financially interrelated entities ^(b)	186,445	203,980
CHI Investment Program	–	73,192
Total assets limited as to use	<u>\$ 981,786</u>	<u>\$ 1,260,569</u>

^(a) PHP has committed capital yet to be called of \$44.6 million and \$38.5 million at December 31, 2018 and 2017, respectively, to private equity funds over the next one to three years.

^(b) Interest in financially interrelated entities are valued in accordance with ASC 820 and are included with the overall investment portfolio of PHP. Asset allocation specific to these entities is 74% marketable equity securities, 19% alternative investments, 6% cash and 1% marketable fixed-income securities.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

D. Assets Limited as to Use (continued)

PHP maintains diversification in its investment programs by allocating assets to various asset classes and market segments and retaining multiple professional investment firms with different philosophies, styles, and approaches. Accordingly, based on this diversification, management does not believe there are any material concentrations of credit risk at December 31, 2018 and 2017.

Funds restricted by donors for charitable purposes, included in cash and cash equivalents, investments, and assets whose use is limited, were \$63.3 million and \$66.1 million at December 31, 2018 and 2017, respectively.

Good Samaritan Hospital

Prior to 2018, a portion of GSH's assets limited as to use were held in the CHI Investment Program. The carrying value of the assets held by participants is an allocation of the underlying carrying value of the assets in the CHI Investment Program, based on the asset allocation specific to each participant and its relative percentage allocation. These proportionate units are accounted for in a similar manner to the equity method of accounting, which are not subject to fair value measurement. During 2018, GSH liquidated the CHI Investment Program and transferred all investments to PHP. For the year ended December 31, 2017, GSH held 1.2% of the total CHI Investment Program. Investment income from the CHI Investment Program, including interest income, realized gains or losses on investments, unrealized gains or losses on investments, CHI assessment, and other expenses, are distributed to participants based on the earnings per pool unit. Gains or losses are realized by participants when pool units are sold, representing the difference between the cost basis and the market value of the pool units sold.

The asset allocation specific to the CHI Investment Program as of December 31, 2017 was as follows:

Marketable equity securities	44%
Marketable fixed-income securities	38
Alternative investments	18
	<hr/>
	100%
	<hr/> <hr/>

E. Fair Value of Assets and Liabilities

The carrying amount reported in the consolidated balance sheets for current assets (other than investments, which are separately disclosed) and current liabilities are reasonable estimates of fair value due to the short-term nature of these financial instruments. These financial instruments are not required to be marked to fair value on a recurring basis, and therefore are not disclosed in the accompanying table. The CHI Investment Program and alternative investments are accounted for similar to the equity method of accounting. The CHI

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

E. Fair Value of Assets and Liabilities (continued)

Investment Program and alternative investments are not required to be marked to fair value on a recurring basis, and therefore are not disclosed in the accompanying table within this note. The carrying amount of the CHI Investment Program and alternative investments approximates fair value based on the nature of the underlying assets.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 are as follows:

	Fair Value Measurements at Reporting Date Using^(a)			
	Total	(Level 1)	(Level 2)	(Level 3)
	<i>(Dollars in Thousands)</i>			
Assets				
Cash and cash equivalents	\$ 87,945	\$ 87,945	\$ –	\$ –
Assets limited as to use:				
Cash and short-term investments	14,755	14,755	–	–
Equity securities	35,575	35,575	–	–
Mutual funds:				
Domestic large cap	14,446	14,446	–	–
Domestic small cap	90	90	–	–
International	97,166	97,166	–	–
Fixed income	217,426	217,426	–	–
Corporate and other bonds:				
Corporate and other bonds	16,901	–	16,901	–
Asset-backed securities	18,421	–	18,421	–
U.S. government securities:				
U.S. government securities	8,428	–	8,428	–
U.S. government agencies	5,417	–	5,417	–
Assets limited as to use before CTFs	428,625	379,458	49,167	–
CTFs measured at NAV ^(b)	128,906	–	–	–
Total assets limited as to use	557,531	379,458	49,167	–
Total assets	\$ 645,476	\$ 467,403	\$ 49,167	\$ –
Liabilities				
Interest rate swap liability	\$ 32,302	\$ –	\$ –	\$ 32,302

^(a) There were no securities transferred between Level 1, 2, or 3 during 2018.

^(b) In accordance with ASC 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

E. Fair Value of Assets and Liabilities (continued)

The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

The following table represents financial instruments at fair value and at other than fair value that reconcile to the consolidated balance sheets of PHP as of December 31, 2018:

	Financial Instruments at Fair Value	Assets and Liabilities at Other Than Fair Value	Total
	<i>(Dollars in Thousands)</i>		
Assets			
Cash and cash equivalents	\$ 87,945	\$ –	\$ 87,945
Assets limited as to use and investments	557,531	424,255	981,786
Total assets	<u>\$ 645,476</u>	<u>\$ 424,255</u>	<u>\$ 1,069,731</u>
Liabilities			
Interest rate swap liability	<u>\$ 32,302</u>	<u>\$ –</u>	<u>\$ 32,302</u>

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

E. Fair Value of Assets and Liabilities (continued)

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2017 are as follows:

	Total	Fair Value Measurements at Reporting Date Using ^(a)		
		(Level 1)	(Level 2)	(Level 3)
<i>(Dollars in Thousands)</i>				
Assets				
Cash and cash equivalents	\$ 55,681	\$ 55,681	\$ —	\$ —
Assets limited as to use:				
Cash and short-term investments	22,407	22,407	—	—
Equity securities	51,652	51,652	—	—
Mutual funds:				
Domestic large cap	23,400	23,400	—	—
Domestic small cap	104	104	—	—
International	177,390	177,390	—	—
Fixed income	218,960	218,960	—	—
Corporate and other bonds:				
Corporate and other bonds	17,472	—	17,472	—
Asset-backed securities	20,262	—	20,262	—
U.S. government securities:				
U.S. government securities	10,559	—	10,559	—
U.S. government agencies	5,056	—	5,056	—
Assets limited as to use before CTFs	547,262	493,913	53,349	—
CTFs measured at NAV ^(b)	191,092	—	—	—
Total assets limited as to use	738,354	493,913	53,349	—
Total assets	\$ 794,035	\$ 549,594	\$ 53,349	\$ —
Liabilities				
Interest rate swap liability	\$ 42,714	\$ —	\$ —	\$ 42,714

^(a) There were no securities transferred between Level 1, 2, or 3 during 2017.

^(b) In accordance with ASC 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

E. Fair Value of Assets and Liabilities (continued)

The following table represents financial instruments at fair value and at other than fair value that reconcile to the consolidated balance sheets of PHP as of December 31, 2017:

	Financial Instruments at Fair Value	Assets and Liabilities at Other Than Fair Value	Total
<i>(Dollars in Thousands)</i>			
Assets			
Cash and cash equivalents	\$ 55,681	\$ —	\$ 55,681
Assets limited as to use and investments	738,354	522,215	1,260,569
Total assets	<u>\$ 794,035</u>	<u>\$ 522,215</u>	<u>\$ 1,316,250</u>
Liabilities			
Interest rate swap liability	<u>\$ 42,714</u>	<u>\$ —</u>	<u>\$ 42,714</u>

Cash and Cash Equivalents and Assets Limited as to Use

PHP's cash and cash equivalents and assets limited as to use comprise cash and short-term investments, money market, equity securities, mutual funds (domestic, international and fixed), corporate bonds and other bonds, asset-backed securities, U.S. government securities, and U.S. government agencies, with the exception of alternative investments, which are accounted for using the equity method of accounting, are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources, primarily matrix pricing, with reasonable levels of price transparency. Matrix pricing, primarily used for marketable fixed-income securities, is based on quoting prices for securities with similar coupons, ratings, and maturities, rather than on specific bids and offers for the specific security. The types of financial instruments based on quoted market prices in active markets include most cash and short-term investments, equity securities, mutual funds and money market securities. Such instruments are generally classified within Level 1 of the fair value hierarchy. PHP does not adjust the quoted market price for such financial instruments.

The types of financial instruments valued based on quoted market prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include corporate and other bonds, asset-backed securities, U.S. government securities, and U.S. governmental agencies. Such financial instruments are generally classified within Level 2 of the fair value hierarchy. Primarily all of PHP's corporate and other bonds, asset-backed securities, U.S. government securities, and U.S. government agencies are actively traded, and the recorded fair value reflects current market conditions. However, due to the inherent volatility in the investment market, there is at least a possibility that recorded investment values may change by a material amount in the near term.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

E. Fair Value of Assets and Liabilities (continued)

Following is the summary of the inputs and valuation techniques as of December 31, 2018 and 2017, used for valuing Level 2 securities in the portfolio:

<u>Securities</u>	<u>Input</u>	<u>Valuation Technique</u>
Corporate and other bonds	Broker/dealer	Market
Asset-backed securities	Broker/dealer	Market/income
U.S. government securities	Broker/dealer	Market
U.S. government agencies	Broker/dealer	Market

The common trust funds are valued at NAV provided by the respective fund administrators. Management has determined that the NAV is an appropriate estimate of fair value of the common trust funds at December 31, 2018 and 2017, based on the fact that the common trust funds are audited and accounted for at fair value by the administrators of the respective common trust funds. There are no restrictions on the ability of PHP to redeem any of the common trust funds at December 31, 2018 or 2017.

Some alternative investments are subject to lock-up provisions that are generally imposed upon initial investment in the fund. Investments that have lock-up provisions longer than one year as of December 31, 2018 and 2017 were \$64.1 million and \$56.9 million, respectively. The remaining alternative investments are not subject to lock-up restrictions.

Interest Rate Swap Agreements

PHP uses interest rate swaps to manage its exposure to fluctuations in interest rates and the overall long-term debt portfolio. PHP's interest rate swap agreements are not traded on an exchange. The valuation of interest rate swap agreements is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each interest rate swap agreement based on the London Interbank Offered Rate (LIBOR), Securities Industry and Financial Markets Association (SIFMA) yield curve or five-year Constant Maturity Swap (5YCMS) and respective fixed rates. The valuation of PHP's interest rate swap agreements is performed by PHP's counterparty and validated through the use of independent third-party valuation, including the unobservable inputs used in the calculation.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

E. Fair Value of Assets and Liabilities (continued)

The following is a summary of key inputs used to determine the fair value for each interest rate swap agreement at December 31:

Interest Rate Swap Agreement	Receiving Floating/Fixed Rate		Paying Fixed/ Floating Rate		Discount Rate
	2018	2017	2018	2017	
May 2011	67% of LIBOR	67% of LIBOR	3.23	3.23	Avg. of LIBOR curve
May 2011	67% of LIBOR⁽¹⁾	67% of LIBOR ⁽¹⁾	SIFMA	SIFMA	Avg. of LIBOR curve
May 2011	67% of LIBOR	67% of LIBOR	3.23	3.23	Avg. of LIBOR curve
May 2011	67% of LIBOR⁽¹⁾	67% of LIBOR ⁽¹⁾	SIFMA	SIFMA	Avg. of LIBOR curve
December 2012	70% of LIBOR	70% of LIBOR	1.748	1.748	Avg. of LIBOR curve
December 2012	70% of LIBOR	70% of LIBOR	1.733	1.733	Avg. of LIBOR curve
April 2007	67% of 5YCMS⁽²⁾	67% of 5YCMS ⁽²⁾	3.12	3.12	Avg. of LIBOR curve
August 2016	5.00	5.00	70% OF LIBOR⁽³⁾	70% OF LIBOR ⁽³⁾	Avg. of LIBOR curve

⁽¹⁾Receiving rate is 67% of LIBOR plus a spread of 0.6395%.

⁽²⁾Receiving rate is 67% of 5YCMS less a spread of 0.458%.

⁽³⁾Paying rate is 70% of LIBOR plus a spread of 0.63%.

The discounted cash flow analysis reflects the contractual terms of the interest rate swap agreement, including the period to maturity, and uses observed market-based inputs, including interest rate curves and implied volatilities. Valuation adjustments are required to be considered in the determination of fair value. This includes amounts to reflect counterparty credit quality and liquidity risk. Although PHP has determined that certain inputs used to value the interest rate swap agreements fall within Level 2 of the fair value hierarchy, certain inputs and the credit valuation adjustment associated with the interest rate swap agreements utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by MAHS, AHS or the counterparty. As a result, PHP has determined that the interest rate swap agreements will be classified in Level 3 of the fair value hierarchy.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

E. Fair Value of Assets and Liabilities (continued)

Level 3 Liabilities

The following table represents the changes in fair value of PHP's Level 3 liabilities (interest rate swap liability) for the years ended December 31:

	<u>2018</u>	<u>2017</u>
	<i>(Dollars in Thousands)</i>	
Balance at January 1	\$ (42,714)	\$ (45,601)
Total unrealized gains (losses) and adjustments included in net income:		
Mark-to-market adjustment	10,981	4,221
Credit valuation adjustment	(569)	(1,334)
Balance at December 31	<u>\$ (32,302)</u>	<u>\$ (42,714)</u>

All realized and unrealized gains (losses) on interest rate swap agreements, including payments due to and from a counterparty, are presented net and included in the consolidated statements of operations and changes in net assets as non-operating gains, net.

F. Property and Equipment

The composition of property and equipment is as follows as of December 31:

	<u>Average</u> <u>Life</u>	<u>2018</u>	<u>2017</u>
		<i>(Dollars in Thousands)</i>	
Land		\$ 77,360	\$ 73,855
Land improvements	8–10 years	45,753	42,363
Buildings	25–40 years	1,386,390	1,230,115
Equipment	3–7 years	881,157	889,044
Capital lease		26,749	26,526
Construction-in-process		37,629	43,570
		<u>2,455,038</u>	<u>2,305,473</u>
Less allowances for depreciation		1,394,572	1,318,238
Property and equipment, net		<u>\$ 1,060,466</u>	<u>\$ 987,235</u>

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

F. Property and Equipment (continued)

PHP had construction commitments of \$37.2 million and \$92.8 million outstanding at December 31, 2018 and 2017, respectively.

Capitalized computer software development costs of \$92.2 million at December 31, 2018 and 2017, related to a clinical information system and enterprise resource planning software implementations are included in equipment. The related amortization included in depreciation expense in the consolidated statements of operations and changes in net assets was \$5.1 million and \$6.4 million for the years ended December 31, 2018 and 2017, respectively.

G. Liability Insurance

PHP and its subsidiaries maintain professional liability coverage through Premier Health International Insurance Limited (PHIIL). PHIIL was formed to provide professional liability, general liability, directors and officers, and employment insurance coverage to the subsidiaries. The liability represents the estimated ultimate cost of all asserted and unasserted claims incurred through the consolidated balance sheet date. The reserve for unpaid losses and loss adjustment expenses is estimated using individual case-based valuations, statistical analyses, and the expertise of an independent actuary. The reserve is undiscounted and based on management's best estimate, which is subject to change. The professional liability, general liability, directors and officers, and employment insurance coverage accrual of \$37.8 million and \$43.6 million at December 31, 2018 and 2017, respectively, is included in the reserve for professional liability in the consolidated balance sheets. PHIIL has excess insurance through a commercial carrier for claims in excess of \$10 million up to \$50 million in the aggregate.

PHP recorded a decrease in insurance expense of approximately \$8.9 million and \$2.9 million in 2018 and 2017, respectively, related to changes in actuarial estimates reflecting lower claim activity, closed claims, tort reform and other environmental factors, and improved claim resolution history.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

H. Long-Term Debt

The details of long-term debt, net of original issue discount/premium and issuance costs, are as follows:

	December 31	
	2018	2017
	<i>(Dollars in Thousands)</i>	
Bonds		
City of Middletown, Ohio, Fixed Rate Revenue Bonds – 2016 Series A, final maturity in 2045, average interest rate was 5.00% (net of unamortized issue cost of \$349 and \$362 in 2018 and 2017, respectively)	\$ 82,591	\$ 82,578
County of Miami, Ohio, Floating Rate Revenue Bonds – 2016 Series B, final maturity in 2026, average interest rate was 1.97% and 1.35% in 2018 and 2017 (net of unamortized issue cost of \$76 and \$86, respectively)	27,489	30,324
County of Montgomery, Ohio, Variable Rate Demand Revenue Bonds – 2016 Series C, final maturity in 2039, average interest rate was 1.37% and 0.78% in 2018 and 2017 (net of unamortized issue cost of \$147 and \$153, respectively)	29,288	29,282
County of Montgomery, Ohio, Variable Rate Demand Revenue Bonds – 2016 Series D, final maturity in 2039, average interest rate was 1.37% and 0.78% in 2018 and 2017 (net of unamortized issue cost of \$145 and \$152, respectively)	27,700	27,693
County of Montgomery, Ohio, Variable Rate Demand Revenue Bonds – 2016 Series E, final maturity in 2045, average interest rate was 1.37% and 0.78% in 2018 and 2017 (net of unamortized issue cost of \$222 and \$230, respectively)	43,603	43,595
County of Montgomery, Ohio, Variable Rate Demand Revenue Bonds – 2016 Series F, final maturity in 2045, average interest rate was 1.37% and 0.78% in 2018 and 2017 (net of unamortized issue cost of \$222 and \$230, respectively)	43,603	43,595
County of Montgomery, Ohio, Fixed Rate Revenue Bonds – 2016 Series G, final maturity in 2046, average interest rate was 3.09% (net of unamortized issue cost of \$2,093 and \$2,355 in 2018 and 2017, respectively)	297,907	297,645

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

H. Long-Term Debt (continued)

	December 31	
	2018	2017
	<i>(Dollars in Thousands)</i>	
County of Montgomery, Ohio, Variable Rate Revenue Bonds – 2012 Series A, final maturity in 2039, average interest rate was 2.40% and 1.77% in 2018 and 2017, respectively (net of unamortized issue cost of \$162 and \$170, respectively)	\$ 77,973	\$ 77,965
County of Montgomery, Ohio, Variable Rate Revenue Bonds – 2012 Series B, refinanced in 2018, average interest rate was 2.36% and 1.73% in 2018 and 2017, respectively (net of unamortized issue cost of \$167 in 2017)	–	47,338
County of Montgomery, Ohio, Fixed Rate Revenue Bonds – 2011 Series A, final maturity in 2023, fixed interest rate was 5.61% and 5.56% in 2018 and 2017 (net of unamortized premium of \$1,760 and \$2,356, respectively, and unamortized issue cost of \$383 and \$482, respectively)	97,087	98,454
County of Montgomery, Ohio, Variable Rate Revenue Bonds – 2009 Series B, final maturity in 2039, average interest rate was 2.28% and 1.52% in 2018 and 2017, respectively	15,000	15,000
County of Montgomery, Ohio, Fixed Rate Revenue Bonds – 2008 Series A, refinanced in 2018, fixed interest rate was 6.00% and 5.80% (net of unamortized discount of \$89 in 2017)	–	16,151
City of Middletown, Ohio, Variable Rate Demand Revenue Bonds – 2008 Series A, final maturity in 2039, average interest rate was 1.42% and 0.84% in 2018 and 2017, respectively	41,425	42,800
City of Middletown, Ohio, Variable Rate Demand Revenue Bonds – 2008 Series B, final maturity in 2039, average interest rate was 1.42% and 0.84% in 2018 and 2017, respectively	41,125	42,500

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

H. Long-Term Debt (continued)

	December 31	
	2018	2017
	<i>(Dollars in Thousands)</i>	
County of Montgomery, Ohio, Variable Rate Demand Revenue Bonds – 2018, used to refinance 2008 Series A and 2012 Series B, final maturity in 2034, average interest rate was 2.69% in 2018	\$ 58,505	\$ –
Total debt, including current portion	883,296	894,920
Notes payable		
Various notes payable, fixed interest rates ranging from 0% to 4.084%, including current portion	21,275	21,735
Capitalized lease obligations		
Total capitalized lease obligations, including current portion	21,081	20,345
Less current portion of debt and capital leases		
Total current portion of debt and capital leases	13,723	14,116
Total long-term debt	\$ 911,929	\$ 922,884

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

H. Long-Term Debt (continued)

Maturities of long-term debt and capitalized leases for the five years succeeding December 31, 2018 and thereafter are as follows (dollars in thousands):

	Consolidated PHP
Bonds:	
2019	\$ 10,345
2020	10,615
2021	46,670
2022	45,540
2023	44,735
Thereafter	<u>727,430</u>
Minimum payments before premiums and issue costs	885,335
Premiums	1,760
Issue costs	<u>(3,799)</u>
Minimum payments on bonds	883,296
Notes payable:	
2019	472
2020	2,123
2021	1,659
2022	1,708
2023	1,758
Thereafter	<u>13,555</u>
Minimum payments on notes payable	21,275
Capital leases:	
2019	4,940
2020	4,050
2021	2,695
2022	2,584
2023	2,528
Thereafter	<u>26,351</u>
Minimum capital lease payments including interest	43,148
Less interest	<u>22,067</u>
Minimum payments on capital leases	21,081
Total minimum payments	925,652
Less current portion	<u>13,723</u>
Total long-term debt	<u><u>\$ 911,929</u></u>

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

H. Long-Term Debt (continued)

On August 1, 2016, Premier Health Partners amended and restated its Master Trust Indenture with the Bank of New York Mellon Trust Company, N.A. (Master Trustee), and formed the Premier Health Partners Obligated Group (PHPOG), which comprises MVH, AMC and UVMC (Members). Under terms of the master indenture, substantially all of the MVH, AMC and UVMC properties, buildings and equipment are leased from the governmental issuer (County of Montgomery, Ohio, City of Middletown, Ohio and County of Miami, Ohio) of all outstanding bonds. Members of the PHPOG are jointly and severally liable for all outstanding obligations, except for the notes payable described in this note. PHPOG is also responsible for the performance of all debt covenants.

On August 31, 2016, PHPOG issued \$82,940,000 of the City of Middletown, Ohio Hospital Facilities Revenue Bonds, Series 2016A fixed rate bonds. The Series 2016A bonds were issued pursuant to a Bond Trust Indenture dated as of August 1, 2016 between PHPOG and The Bank of New York Mellon Trust Company, and underwritten by Barclays Bank PLC. The 2016A bonds were used to call and extinguish the City of Middletown, Ohio variable rate Series 2010A revenue bonds issued by Wells Fargo, in the amount of \$86,000,000, and to pay certain costs related to the issuance of the bonds and the extinguishment of the Series 2010A Bonds. PHPOG paid an average coupon rate of 5.00% in 2016. The 2016A bonds have an embedded put option that will expire on November 15, 2023.

On August 31, 2016, PHPOG issued \$33,210,000 of the County of Miami, Ohio Hospital Facilities Revenue Bonds, Series 2016B floating rate bonds. The Series 2016B bonds were issued pursuant to a Bond Trust Indenture dated as of August 1, 2016 between PHPOG and The Bank of New York Mellon Trust Company and were privately placed with and underwritten by Bank of America Merrill Lynch. The 2016B bonds have an embedded put option that will expire on May 15, 2021 and a final maturity of November 15, 2026.

On August 31, 2016, PHPOG issued \$29,435,000 of the County of Montgomery, Ohio Hospital Facilities Revenue Bonds, Series 2016C and \$27,845,000 of the County of Montgomery, Ohio Revenue Bond, Series 2016D variable rate demand bonds. The Series 2016C and 2016D bonds were issued pursuant to a Bond Trust Indenture dated as of August 1, 2016 between PHPOG and The Bank of New York Mellon Trust Company, and underwritten by Barclays Bank PLC. These Series 2016 C and D Bonds are backed by Barclay's Letter of Credit and will expire on August 29, 2020.

On August 31, 2016, PHPOG issued \$43,825,000 of the County of Montgomery, Ohio Hospital Facilities Revenue Bonds, Series 2016E and \$43,825,000 of the County of Montgomery, Ohio Revenue Bond, Series 2016F variable rate demand bonds. The Series 2016E and 2016F bonds were issued pursuant to a Bond Trust Indenture dated as of August 1, 2016 between PHPOG and The Bank of New York Mellon Trust Company, and underwritten by Barclays Bank PLC. These Series 2016 E and F Bonds are backed by Barclay's Letters of Credit and will expire on August 29, 2020.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

H. Long-Term Debt (continued)

On August 31, 2016, PHPOG issued \$300,000,000 of the County of Montgomery, Ohio Taxable Hospital Revenue Bonds, Series 2016G fixed rate bonds. The Series 2016G bonds were issued pursuant to a Bond Trust Indenture dated as of August 1, 2016 between PHPOG and The Bank of New York Mellon Trust Company, and underwritten by Barclays Bank PLC. PHPOG will pay a taxable rate of 2.911% on \$250 million and a taxable rate of 3.992% on the remaining \$50 million. The 2016G bond agreement has \$250 million that will expire November 15, 2026 and \$50 million that will expire on November 15, 2046.

The 2012A Series Bonds were privately placed with PNC Bank, and were issued and secured under the terms of the agreement, dated November 1, 2012. The 2012A bond agreement has an embedded put option on November 15, 2022.

The 2011A Series Bonds were issued and secured under the terms of a Bond Trust Indenture dated as of April 1, 2011, between PHPOG and the Bank of New York Mellon Trust Company.

On November 15, 2017, PHPOG refinanced \$15,000,000 of the County of Montgomery, Ohio Hospital Facilities Revenue Bonds, Series 2009B bonds, which are secured by a floating rate bond purchase agreement with PNC Bank. The previous purchase agreement was with Fifth Third Bank. The 2009B bond agreement has an embedded put option on November 15, 2024.

The 2008A and 2008B Series, City of Middletown, Ohio Hospital Facilities Revenue Bonds, are secured by a Letter of Credit for each series (Letters of Credit) between PHPOG and PNC Bank. The Letters of Credit will expire on March 12, 2024.

On December 12, 2018, PHPOG issued \$58,505,000 of the County of Montgomery, Ohio Hospital Facilities Revenue Bonds, Series 2018 bonds, which are secured by a floating rate bond purchase agreement with J.P. Morgan. The Series 2018 bonds were used to extinguish the 2008A Series, County of Montgomery, Ohio Hospital Facilities Revenue Bonds, secured under the terms of Merrill Lynch Bank, and the 2012B Series Bonds that were privately placed with Fifth Third Bank, which were issued and secured under the terms of the agreement, dated November 1, 2012. The 2018 bond purchase agreement has a final maturity date of November 15, 2034 and has an embedded put option on December 20, 2023.

The bond agreements and Letters of Credit include certain restrictive covenants, which include among other things, minimum requirements for leverage ratio, cash, and revenues available for debt service. At December 31, 2018 and 2017, PHP was in compliance with its financial debt covenants.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

H. Long-Term Debt (continued)

Notes Payable

In May 2012, MAHS and MVH entered into a financing arrangement, within the guidelines of the Internal Revenue Service's New Market Tax Program, to fund a capital project. The arrangement called for the creation of a new limited liability company (Premier Plaza, LLC) for which 100% interest is owned by MAHS and MVH. As part of this arrangement, MAHS and a third-party investor were required to loan \$12.5 million and \$5.2 million, respectively, to a group of qualified community development entities (CDEs) through an investment fund. These CDEs subsequently loaned \$17.7 million back to Premier Plaza, LLC for purposes of funding the capital project through four notes with interest rates ranging from 1.0% to 4.1% and 20-year terms. Payment on the CDE notes is guaranteed by MVH in the event of default. The loans are also secured by a collateral security interest in the future stream of lease rental payments to be received by Premier Plaza, LLC.

In July 2017, SHP entered into a financing arrangement to purchase land in the amount of \$5.0 million, to be paid in equal annual installments beginning July 31, 2018 to July 31, 2025. This amount is included in notes payable.

For the years ended December 31, 2018 and 2017, interest paid was \$26.6 million and \$26.7 million, respectively. For the years ended December 31, 2018 and 2017, capitalized interest was \$1.4 million and \$0.2 million, respectively.

I. Pension Plan

The Premier Health Partners Employees Retirement Plan (PHP Plan) was formed on January 1, 2013. Participants of the PHP Plan earn benefits using formulas that existed under the defined benefit plans for MAHS Plan, GSH Plan, AHS Plan, and UVMC Plan for employees hired before January 1, 2008. The formulas for MAHS Plan, GSH Plan, AHS Plan, and UVMC Plan are primarily based on the total of retirement income and/or service credits calculated using various percentages of annual earnings depending on the year of employment. Individuals participating under these formulas are 100% vested in all amounts credited to their accounts upon the completion of three vesting years as defined by the PHP Plan. In December 2016, PHP's board approved an amendment to the PHP Plan for participants hired prior to January 1, 2008. For these affected participants, their formulas were frozen as of January 1, 2018, and they are covered under the cash balance formula.

Individuals hired after January 1, 2008 earn benefits based on a percentage of compensation and with escalating percentages related to years of service (cash balance formula). Individuals earning benefits under this formula shall become 100% vested in all amounts credited to their accounts upon completion of three vesting years, as defined in the PHP Plan. If a participant's employment is terminated, other than by death

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

I. Pension Plan (continued)

or disability, prior to such participant becoming 100% vested in his or her account, the account shall be forfeited as of the date of termination. Vested benefits for individuals hired after January 1, 2008, are fully portable upon termination of employment.

PHP's funding policy is to contribute amounts to the PHP Plan sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974 (ERISA). PHP recognizes in the consolidated balance sheets the funded status of its defined benefit pension plans, measured as the difference between the fair value of plan assets and the projected benefit obligation. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic cost in the same periods will be recognized as a component of unrestricted net assets.

The following table sets forth the funded status of PHP's pension plans and the amounts recognized in the consolidated balance sheets for the years ended December 31:

	2018	2017
	<i>(Dollars in Thousands)</i>	
Accumulated benefit obligation	\$ 673,430	\$ 720,457
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	\$ 728,026	\$ 655,347
Service cost	23,368	23,134
Interest cost	24,397	23,696
Actuarial (gain) loss	(36,160)	57,639
Benefits paid	(59,325)	(31,790)
Projected benefit obligation at end of year	680,306	728,026
Change in plan assets		
Fair value of plan assets at beginning of year	693,755	600,799
Actual return on plan assets	(44,888)	85,104
Contributions	9,100	39,642
Benefits paid	(59,325)	(31,790)
Fair value of plan assets at end of year	\$ 598,642	\$ 693,755
Funded status and net pension liability	\$ (81,664)	\$ (34,271)

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

I. Pension Plan (continued)

Included as a reduction in net assets without donor restrictions are the following amounts that have not yet been recognized in net periodic pension expense as of December 31:

	2018	2017
	<i>(Dollars in Thousands)</i>	
Net prior service credit	\$ 26,584	\$ 29,793
Net actuarial loss	(277,768)	(241,024)
	\$ (251,184)	\$ (211,231)

Net actuarial loss is amortized as a component of net periodic pension cost, only if the losses exceed 10% of the greater of the projected benefit obligation or the fair value of plan assets. Net prior service credit is amortized on a straight-line basis over the estimated life of the PHP Plan's participants. The net prior service credit and net actuarial loss included as a reduction in unrestricted net assets that is expected to be recognized in net periodic pension expense during the year ending December 31, 2019 are \$3.2 million and \$14.7 million, respectively, for the PHP plan.

The following amounts related to pension benefit activity have been recognized in net assets without donor restrictions for the years ended December 31:

	2018	2017
	<i>(Dollars in Thousands)</i>	
Net actuarial loss	\$ (53,952)	\$ (15,031)
Amortization of actuarial loss	17,208	13,911
Amortization of unrecognized prior service credit	(3,209)	(2,475)
Decrease in net assets without donor restrictions	\$ (39,953)	\$ (3,595)

Net pension expense included the following components for the years ended December 31:

	2018	2017
	<i>(Dollars in Thousands)</i>	
Service cost	\$ 23,368	\$ 23,134
Interest cost	24,397	23,696
Expected return on assets	(45,224)	(42,496)
Amortization of unrecognized prior service credit	(3,209)	(2,475)
Amortization of actuarial loss	17,208	13,911
Net pension expense	\$ 16,540	\$ 15,770

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

I. Pension Plan (continued)

Weighted-average assumptions to determine the benefit obligation for the PHP Plan are as follows as of December 31:

	<u>2018</u>	<u>2017</u>
Discount rate	4.43%	3.74%
Average salary increase rate	3.97	3.00

Weighted-average assumptions to determine the net periodic benefit expense for the PHP Plan are as follows for the years ended December 31:

	<u>2018</u>	<u>2017</u>
Discount rate	3.74%	4.30%
Interest cost discount rate on benefit obligations	3.37	3.65
Service cost discount rate	3.78	4.38
Interest cost discount rate on service cost	3.22	3.73
Long-term rate of return	6.75	6.75
Average salary increase rate	3.00	3.00

In selecting the expected long-term return on plan assets for the PHP Plan, management considered the average rate of earnings on the funds invested or to be invested to provide for the benefits of the plan. This includes the asset allocation and the expected returns that are expected to be earned over the life of the plan. This basis is consistent with the prior year.

Projected benefit payments for the ten years succeeding December 31, 2018 are as follows:

	<u>PHP Plan</u>
2019	\$ 33,040
2020	35,791
2021	38,331
2022	41,031
2023	43,718
2024–2028	243,984
	<u>\$ 435,895</u>

PHP expects to make a \$9.0 million contribution to its pension plan in 2019.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

I. Pension Plan (continued)

The fair values of the PHP Plan's assets at December 31, 2018, by asset category, are as follows:

Asset Category	Total	Fair Value Measurements ^(a)		
		(Level 1)	(Level 2)	(Level 3)
<i>(Dollars in Thousands)</i>				
Cash and short-term investments	\$ 32,955	\$ 32,955	\$ —	\$ —
Mutual funds:				
Domestic small cap	23,404	23,404	—	—
International	41,648	41,648	—	—
Corporate and other bonds:				
Corporate and other bonds	132,170	—	132,170	—
U.S. government securities:				
U.S. government securities	143,933	—	143,933	—
CTFs measured at NAV ^(b)	98,558	—	—	—
Alternative investments measured at NAV ^(b) :				
Limited liability companies	91,820	—	—	—
Hedge funds	34,154	—	—	—
Total PHP Plan assets	\$ 598,642	\$ 98,007	\$ 276,103	\$ —

^(a) There were no securities transferred between Level 1, 2, or 3 during 2018.

^(b) In accordance with ASC 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

I. Pension Plan (continued)

The fair values of the PHP Plan's assets at December 31, 2017, by asset category, are as follows:

Asset Category	Total	Fair Value Measurements ^(a)		
		(Level 1)	(Level 2)	(Level 3)
<i>(Dollars in Thousands)</i>				
Cash and short-term investments	\$ 24,741	\$ 24,741	\$ —	\$ —
Mutual funds:				
Domestic small cap	29,019	29,019	—	—
International	69,950	69,950	—	—
Corporate and other bonds:				
Corporate and other bonds	141,707	—	141,707	—
U.S. government securities:				
U.S. government securities	162,700	—	162,700	—
CTFs measured at NAV ^(b)	129,951	—	—	—
Alternative investments measured at NAV ^(b) :				
Limited liability companies	86,958	—	—	—
Hedge funds	48,729	—	—	—
Total PHP Plan assets	\$ 693,755	\$ 123,710	\$ 304,407	\$ —

^(a) There were no securities transferred between Level 1, 2, or 3 during 2017.

^(b) In accordance with ASC 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

Fair value methodologies for cash and short-term investments, mutual funds including common trust funds, corporate and other bonds, and U.S. government securities sections included in Level 1 and Level 2 are consistent with the inputs described in Note E.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

I. Pension Plan (continued)

Following is the summary of the inputs and valuation techniques as of December 31, 2018 and 2017, used for valuing Level 2 securities in the portfolio:

<u>Securities</u>	<u>Input</u>	<u>Valuation Technique</u>
Corporate and other bonds	Broker/dealer	Market
U.S. government securities	Broker/dealer	Market

The CTFs are valued at NAV provided by the respective fund administrators. Management has determined that the NAV is an appropriate estimate of the fair value of the CTFs at December 31, 2018 and 2017, based on the fact the CTFs are audited and accounted for at fair value by the administrators of the respective CTFs. There are no restrictions on the ability of PHP to redeem any of the CTFs at December 31, 2018 or 2017.

Alternative investments, which consist of hedge funds and limited liability companies, are not necessarily readily marketable and may include short sales on securities and trading in future contracts, options, foreign currency contracts, other derivative instruments, and private equity investments. However, management has determined that the NAV is an appropriate estimate of the fair value of these investments at December 31, 2018, based on the fact that the alternative investments are audited and accounted for at fair value by the administrators of the respective alternative investments. Alternative investments can be divested only at specified times in accordance with terms of the partnership agreements. Hedge fund and limited liability companies' redemptions typically contain restrictions that allow for a portion of the withdrawal proceeds to be held back from distribution while the underlying investments are liquidated.

PHP's pension plan target asset allocations by asset category as of December 31, 2018 is 50% return seeking assets and 50% liability-driven investments. The target asset allocations as of December 31, 2017 were 58% equity securities, 37% fixed income and 5% real estate.

PHP's objective for the pension plan is to provide the payment of all future participant benefits. To meet this objective, the plan assets are invested in a manner that considers asset and liability movements and prudent efforts are made to exceed growth in liabilities. The PHP Plan is actively invested to achieve growth of capital and capital preservation. PHP maintains diversification in its plan assets by allocating assets to various asset classes and market segments and retaining multiple professional investment firms with different philosophies, styles, and approaches. Consideration is given to variables such as productivity, inflation, global competitiveness, and market risk. PHP's objective for the PHP Plan is to have 35% to 68% invested in return seeking assets and 32% to 65% invested in liability-driven investments with a specific asset class target disclosed in the table within this note. Accordingly, based on this diversification, management does not believe there are any concentrations of credit at the measurement date.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

J. Interest Rate Swaps

The following table summarizes the notional and valuation assets (liabilities) of PHP's interest rate swaps as of December 31 (in millions):

Interest Rate Swap Agreement	Transaction Type	Termination Date	Notional Amount		Valuation Amount	
			2018	2017	2018	2017
April 2007	Fixed Pay	2039	\$ 92.6	\$ 94.4	\$ (16.0)	\$ (19.9)
May 2011	Fixed Pay	2045	42.5	42.5	(10.6)	(12.7)
May 2011	Fixed Pay	2045	42.5	42.5	(11.0)	(13.2)
May 2011	Basis swap	2037	50.0	50.0	1.7	1.8
May 2011	Basis swap	2037	50.0	50.0	1.7	2.0
December 2012	Fixed Pay	2039	78.1	78.1	1.0	(0.7)
December 2012	Fixed Pay	2039	47.5	47.5	0.6	(0.3)
August 2016	Total					
	Return	2023	82.9	82.9	0.3	0.3
Total liability					\$ (32.3)	\$ (42.7)

PHP's interest rate swap agreements include certain collateralization requirements based on the market value of these transactions. The amount required for collateral is determined daily based on the current market value of the interest rate swap agreements. PHP has posted collateral with a designated custodian of \$9.3 million at December 31, 2018 (\$13.4 million at December 31, 2017) commensurate with the valuation of the interest rate swap agreements. All collateral posted is in the form of cash and cash equivalents and is included in other assets on the consolidated balance sheets, restricted for interest rate swap agreements collateral requirements. Interest earned while collateralized funds are held by the custodian is shown in non-operating gains, net on the consolidated statements of operations and changes in net assets.

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

K. Non-operating (Losses) Gains, Net

Non-operating (losses) gains, net are as follows:

	Year Ended December 31	
	2018	2017
	<i>(Dollars in Thousands)</i>	
Interest income, net of investment fees	\$ 19,231	\$ 17,214
Realized gains on assets whose use is limited	14,847	38,894
Change in unrealized (losses) gains on assets whose use is limited	(73,004)	92,162
Unrealized gains on interest rate swaps	10,578	2,976
CHI assessment	–	(3,795)
Other losses	(16,483)	(13,995)
Non-operating (losses) gains, net	<u>\$ (44,831)</u>	<u>\$ 133,456</u>

L. Concentration of Credit Risk

PHP's primary purpose is to provide healthcare services. PHP grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors was as follows at December 31:

	2018	2017
Medicare	35%	37%
Medicaid	17	22
Anthem	9	10
United HealthCare	5	2
Other third-party payors	15	14
Patients' responsibility	19	15
Total	<u>100%</u>	<u>100%</u>

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

M. Goodwill and Intangible Assets, Net

Goodwill and intangible assets have been generated primarily from the acquisition of certain businesses. The following table sets forth the related carrying values of goodwill and other intangibles, as of December 31:

	2018	2017
	<i>(Dollars in Thousands)</i>	
Goodwill balance, January 1,	\$ 27,807	\$ 14,993
Goodwill acquired	2,831	12,814
Purchase accounting adjustment	1,782	—
Goodwill balance, December 31,	<u>32,420</u>	27,807
Intangible asset, December 31,	8,282	7,898
Intangible asset accumulated amortization	<u>(6,381)</u>	<u>(4,928)</u>
Net intangible assets	1,901	2,970
Total goodwill and intangible assets, December 31,	<u>\$ 34,321</u>	<u>\$ 30,777</u>

Amortization expense for the years ended December 31, 2018 and 2017 was \$1.8 million and \$1.4 million, respectively.

In 2018, PHP acquired the remaining ownership interest in a business in which it had a controlling interest, resulting in an increase to goodwill of \$2.8 million.

In 2017, PHP acquired an additional ownership interest in a business in which it had an equity interest, giving PHP a controlling interest, resulting in an increase to goodwill of \$12.8 million.

N. Operating Leases

PHP leases certain buildings from third parties in the form of operating leases. The related rental expense for the buildings was \$7.0 million for the years ended December 31, 2018 and 2017. The following is a schedule of aggregate future minimum payments under the operating leases as of December 31, 2018:

2019	\$ 7,660
2020	6,769
2021	5,363
2022	4,061
2023	3,529
Thereafter	15,406
Total	<u>\$ 42,788</u>

Premier Health Partners and Subsidiaries

Notes to Consolidated Financial Statements (continued)

O. Subsequent Events

PHP has evaluated subsequent events through March 14, 2019, which is the date the consolidated financial statements were issued and made available. No recognized or unrecognized subsequent events were identified for recognition or disclosure in the consolidated financial statements.

P. Cost of Community Benefits (Unaudited)

Cost of Community Benefit	2018 PHP	PHP % of Operating Expense	2017 PHP	PHP % of Operating Expense
<i>(Dollars in Thousands)</i>				
Charity care and means-tested government programs				
Charity care at cost	\$ 21,460		\$ 27,817	
Unreimbursed Medicaid	122,696		109,853	
Unreimbursed costs – other means-tested government programs	5,975		7,122	
Total charity care and means-tested government programs	150,131	7.7%	144,792	7.8%
Other benefits				
Community health improvement and community benefit operations	3,329		2,874	
Health professions education	7,297		4,151	
Subsidized health services	42,309		43,889	
Cash and in-kind contributions to community groups	6,319		6,959	
Total other benefits	59,254	3.1%	57,873	3.1%
Total quantifiable benefits	209,385	10.8%	202,665	10.9%
Community building activities				
Physical improvements	638		665	
Other	80		591	
Total community building activities	718	0.0%	1,256	0.1%
Total Medicare	133,856	6.9%	131,407	7.1%
Total community benefits	\$ 343,959	17.7%	\$ 335,328	18.1%

Medicaid and Medicare include total costs.

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