

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Sisters of Charity of Leavenworth Health System, Inc.
Years Ended December 31, 2017 and 2016
With Reports of Independent Auditors

Ernst & Young LLP



Sisters of Charity of Leavenworth Health System, Inc.

Consolidated Financial Statements and
Supplementary Information

Years Ended December 31, 2017 and 2016

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Ernst & Young LLP
Suite 3300
370 17th Street
Denver, CO 80202

Tel: +1 720 931 4000
Fax: +1 720 931 4444
ey.com

Report of Independent Auditors

The Board of Directors
Sisters of Charity of Leavenworth
Health System, Inc.

We have audited the accompanying consolidated financial statements of Sisters of Charity of Leavenworth Health System, Inc. (SCL Health), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, 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 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 SCL Health as of December 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

May 4, 2018

Sisters of Charity of Leavenworth Health System, Inc.

Consolidated Balance Sheets

	December 31	
	2017	2016
	<i>(In Millions)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 137.4	\$ 168.6
Current portion of investments	204.6	203.5
Accounts receivable:		
Patient (less allowance for uncollectible accounts of \$102.1 million and \$106.6 million at December 31, 2017 and 2016, respectively)	311.9	274.8
Pledges receivable, net and other	44.5	26.2
Third-party settlements	5.2	7.5
Inventory	49.5	44.2
Prepays and other assets	37.1	35.0
Assets held for sale	—	85.2
Total current assets	<u>790.2</u>	<u>845.0</u>
Investments, net of current portion	1,764.3	1,451.2
Assets limited as to use:		
Self-insured risks	41.7	41.6
Trustee-held funds	12.9	12.3
	<u>54.6</u>	<u>53.9</u>
Land, buildings, and equipment, net	2,050.9	2,025.6
Other assets:		
Investments in joint ventures	29.2	32.7
Pledges receivable, net	2.6	4.4
Other assets	21.9	21.8
	<u>53.7</u>	<u>58.9</u>
Total assets	<u><u>\$ 4,713.7</u></u>	<u><u>\$ 4,434.6</u></u>

	December 31	
	2017	2016
	<i>(In Millions)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 104.4	\$ 88.4
Accrued salaries, wages, and benefits	122.1	109.5
Accrued interest payable	25.8	26.2
Other accrued expenses	27.0	47.7
Third-party settlements	50.0	30.2
Current maturities of long-term obligations	177.4	176.1
Due to broker	30.6	–
Liabilities held for sale	–	17.4
Total current liabilities	<u>537.3</u>	<u>495.5</u>
Other non-current liabilities:		
Reserve for self-insured risks	41.7	41.6
Accrued pension payable	0.6	18.0
Accrued swap liability	15.8	18.0
Other liabilities	38.3	29.9
	<u>96.4</u>	<u>107.5</u>
Bonds payable, other notes, and capital lease obligations, net of current maturities	<u>1,173.7</u>	<u>1,203.8</u>
Total liabilities	<u>1,807.4</u>	<u>1,806.8</u>
Net assets:		
Attributable to SCL Health	2,841.9	2,562.6
Attributable to non-controlling interests	2.1	1.3
Total unrestricted	<u>2,844.0</u>	<u>2,563.9</u>
Temporarily restricted	41.1	40.1
Permanently restricted	21.2	23.8
Total net assets	<u>2,906.3</u>	<u>2,627.8</u>
Total liabilities and net assets	<u>\$ 4,713.7</u>	<u>\$ 4,434.6</u>

See accompanying notes.

Sisters of Charity of Leavenworth Health System, Inc.

Consolidated Statements of Operations

	Year Ended December 31	
	2017	2016
	<i>(In Millions)</i>	
Operating revenue:		
Net patient service revenue before provision for bad debts	\$ 2,590.1	\$ 2,462.9
Provision for bad debts	<u>(51.7)</u>	<u>(61.6)</u>
Net patient service revenue	2,538.4	2,401.3
Other operating revenue	67.7	58.1
Net assets released from restrictions	29.0	24.4
Net loss from joint ventures	(24.0)	(5.6)
Net gain (loss) from disposal of assets	<u>4.7</u>	<u>(2.5)</u>
Total operating revenue	2,615.8	2,475.7
Operating expenses:		
Salaries and wages	1,052.8	1,000.9
Associate benefits	234.7	248.1
Other operating expenses	976.7	892.7
Depreciation and amortization	155.0	153.6
Interest and amortization	<u>59.2</u>	<u>62.7</u>
Total operating expenses	2,478.4	2,358.0
Income from continuing operations	137.4	117.7
Non-operating gains (losses)		
Income tax expense	(3.5)	(3.4)
Investment income, net	205.6	99.5
Loss on early extinguishment of debt	-	(17.2)
Other gains (losses)	<u>1.3</u>	<u>(0.5)</u>
Total non-operating gains	203.4	78.4
Excess of revenue over expenses	340.8	196.1
Less amounts attributable to non-controlling interests	<u>2.6</u>	<u>(1.8)</u>
Excess of revenue over expenses attributable to SCL Health	<u>\$ 338.2</u>	<u>\$ 197.9</u>

See accompanying notes.

Sisters of Charity of Leavenworth Health System, Inc.

Consolidated Statements of Changes in Net Assets

	Year Ended December 31, 2017			Year Ended December 31, 2016		
	Total	Controlling	Non-controlling	Total	Controlling	Non-controlling
	<i>(In Millions)</i>			<i>(In Millions)</i>		
Unrestricted net assets						
Excess of revenue over expenses	\$ 340.8	\$ 338.2	\$ 2.6	\$ 196.1	\$ 197.9	\$ (1.8)
Loss from discontinued operations	(72.1)	(72.1)	–	(77.3)	(77.3)	–
Amortization of accumulated losses on interest rate swaps	2.2	2.2	–	(1.2)	(1.2)	–
Contributions from non-controlling interests	–	–	–	0.3	–	0.3
Distributions to non-controlling interests	(1.8)	–	(1.8)	(2.4)	–	(2.4)
Pension-related charges other than net periodic pension costs	12.9	12.9	–	(1.8)	(1.8)	–
Net assets released for capital acquisitions	0.5	0.5	–	3.6	3.6	–
Other	(2.4)	(2.4)	–	–	–	–
	280.1	279.3	0.8	117.3	121.2	(3.9)
Temporarily restricted net assets						
Contributions	24.6	24.6	–	28.0	28.0	–
Net investment income	0.6	0.6	–	0.6	0.6	–
Temporarily restricted net assets reclassification	–	–	–	0.4	0.4	–
Net assets released from restrictions	(24.2)	(24.2)	–	(28.0)	(28.0)	–
	1.0	1.0	–	1.0	1.0	–
Permanently restricted net assets						
Contributions	1.3	1.3	–	0.2	0.2	–
Net investment income	1.4	1.4	–	0.6	0.6	–
Permanently restricted net assets reclassification	(5.3)	(5.3)	–	(0.4)	(0.4)	–
	(2.6)	(2.6)	–	0.4	0.4	–
Increase (decrease) in net assets	278.5	277.7	0.8	118.7	122.6	(3.9)
Beginning net assets	2,627.8	2,626.5	1.3	2,509.1	2,503.9	5.2
Ending net assets	\$ 2,906.3	\$ 2,904.2	\$ 2.1	\$ 2,627.8	\$ 2,626.5	\$ 1.3

See accompanying notes.

Sisters of Charity of Leavenworth Health System, Inc.

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2017	2016
	<i>(In Millions)</i>	
Operating activities		
Increase in net assets	\$ 278.5	\$ 118.7
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	155.0	161.6
Loss on assets held for sale	49.1	36.6
Provision for bad debts	56.1	70.1
Increase in accounts receivable	(75.5)	(82.4)
Change in unrealized value of interest rate swaps	(2.2)	1.2
Restricted contributions	(25.9)	(28.2)
Pension-related charges other than net periodic pension costs	(12.9)	(2.1)
Net assets released for capital acquisitions	(0.5)	(3.6)
Net loss from joint ventures	25.0	5.4
Net (gain) loss from disposal of assets	(4.7)	2.5
(Increase) decrease in investments	(314.9)	174.6
(Increase) decrease in other assets	3.0	(2.5)
Increase (decrease) in liabilities	44.6	(17.2)
Net cash provided by operating activities	<u>174.7</u>	<u>434.7</u>
Investing activities		
Acquisition of land, buildings, and equipment	(185.2)	(189.8)
Increase in investments in joint ventures	(18.4)	(7.0)
Net cash used in investing activities	<u>(203.6)</u>	<u>(196.8)</u>
Financing activities		
Restricted contributions	25.9	28.2
Net assets released for capital acquisitions	0.5	3.6
Proceeds from issuance of long-term debt, net of original issue discount and financing costs	–	219.6
Payments on bonds, notes, and capital leases obligations	(28.7)	(37.6)
Defeasance of bonds payable, including call and interest premium	–	(363.4)
Net cash used in financing activities	<u>(2.3)</u>	<u>(149.6)</u>
Net increase (decrease) in cash and cash equivalents	(31.2)	88.3
Beginning cash and cash equivalents	168.6	80.3
Ending cash and cash equivalents	<u>\$ 137.4</u>	<u>\$ 168.6</u>

See accompanying notes.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements

December 31, 2017

1. Organization

The Sisters of Charity of Leavenworth Health System, Inc. (SCL Health) is a Catholic ministry that operates as a Kansas not-for-profit corporation, headquartered in Denver, Colorado. Leaven Ministries is a canonical entity and the sponsor of SCL Health. The mission of SCL Health is to reveal and foster God’s healing love by improving the health of the people and communities SCL Health serves, especially those who are poor and vulnerable.

The primary ministry of SCL Health is to witness the Gospel of Jesus by striving to provide high-quality health care in a spirit of justice and charity. Services are provided based on community need and available resources, with special concern for the poor and underserved. The ministry is carried out in many ways, including the provision of health care services at various locations.

SCL Health controls a group of related entities identified as Affiliates (collectively referred to as SCL Health). On November 1, 2017, SCL Health divested St. Francis Hospital in Topeka, Kansas, to The University of Kansas Health System and Ardent Health Services. See Note 3, Discontinued Operations.

The following organizations comprise the Affiliates that are owned by or affiliated with SCL Health directly or indirectly through sole or shared corporate membership or management control. All Affiliates listed below are included in the accompanying consolidated financial statements. Restricted Affiliates is a defined term under the Master Trust Indenture (MTI). See Note 7 for discussion regarding the Restricted Affiliates.

Restricted Affiliates	Location
Kansas	
St. Francis Health Center, Inc. ⁽¹⁾	Topeka, Kansas
Colorado	
SCL Health – Front Range, Inc. (d/b/a Lutheran Medical Center)	Denver, Colorado
Lutheran Medical Center Foundation	Wheat Ridge, Colorado
Good Samaritan Medical Center, LLC (GSMC)	Lafayette, Colorado
Good Samaritan Medical Center Foundation	Lafayette, Colorado
Saint Joseph Hospital, Inc. (SJH)	Denver, Colorado
St. Mary’s Hospital & Medical Center, Inc.	Grand Junction, Colorado

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization (continued)

Restricted Affiliates	Location
Montana	
Holy Rosary Healthcare	Miles City, Montana
SCL Health Medical Group – Miles City, LLC	Miles City, Montana
St. James Healthcare	Butte, Montana
St. Vincent Healthcare	Billings, Montana
Other Affiliates	Location
Kansas	
St. Francis Health Center Foundation	Topeka, Kansas
Caritas Clinics, Inc.	Leavenworth and Kansas City, Kansas
Marian Clinic, Inc.	Topeka, Kansas
Caritas, Inc. and Subsidiaries	Lenexa, Kansas
Colorado	
Saint Joseph Hospital Foundation	Denver, Colorado
SCL Health Medical Group – Denver, LLC	Denver, Colorado
St. Mary’s Hospital Foundation	Grand Junction, Colorado
SCL Health Medical Group – Grand Junction, LLC	Grand Junction, Colorado
Platte Valley Medical Center (PVMC)	Brighton, Colorado
Mount St. Vincent Home, Inc.	Denver, Colorado
SCL Home Health Solutions, LLC	Denver, Colorado
SCL Health Partners, LLC	Denver, Colorado
Montana	
St. James Healthcare Physician Billing, LLC	Billings, Montana
SCL Health Medical Group – Billings, LLC	Billings, Montana
St. Vincent Healthcare Foundation, Inc.	Billings, Montana
St. James Healthcare Foundation, Inc.	Butte, Montana
Holy Rosary Healthcare Foundation, Inc.	Miles City, Montana
Grand Cayman, BWI	
Leaven Insurance Company, Ltd.	Georgetown, Grand Cayman, BWI

⁽¹⁾ Restricted Affiliate held for sale as of December 31, 2016, and divested on November 1, 2017.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies

Principles of Consolidation

All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements. Joint ventures are consolidated if SCL Health has the ability to control the entity through direct or indirect ownership of a majority voting interest or through management control.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly-liquid debt instruments with a maturity of three months or less when purchased that have not otherwise been classified as assets limited as to use by board designation or other arrangements under trust agreements.

Accounts Receivable

SCL Health provides health care services through inpatient, outpatient, and ambulatory care facilities and grants credit to patients, substantially all of whom are local residents in the communities served by SCL Health. SCL Health generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies, including, but not limited to, Medicare, Medicaid, health maintenance organizations, and commercial insurers.

The allowance for uncollectible accounts is based on management's assessment of historical and expected net collections, considering the business and general economic conditions in its service area, trends in health care coverage, and other collection indicators. Throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based on historical collection experience by payor category and other factors. The results of these reviews are then used to make modifications to the allowance for uncollectible accounts. The allowance for uncollectible accounts includes a reserve for both uninsured patients and balances due from patients after insurance. At December 31, 2017 and 2016, the allowance for uncollectible accounts was \$102.1 million and \$106.6 million, respectively.

Following is a rollforward of the allowance for uncollectible accounts as reflected in the accompanying consolidated balance sheets:

	2017	2016
	<i>(In Millions)</i>	
Balance, beginning of year	\$ 106.6	\$ 95.5
Provision for bad debts	51.7	61.6
Write-offs, net of recoveries	(56.2)	(50.5)
Balance, end of year	<u>\$ 102.1</u>	<u>\$ 106.6</u>

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Inventory

Inventory consists primarily of medical supplies and pharmaceuticals and is stated at the lower of cost, generally on the first-in, first-out basis, or market.

Investments and Assets Limited as to Use

SCL Health holds the majority of its investments through the Comprehensive Investment Program (CIP), an investment pool of funds in which a limited number of unaffiliated nonprofit entities participate. SCL Health does not consolidate the entire investment pool of funds, as a portion of the investments represents the interests of other entities. Accordingly, SCL Health's investments recorded in the accompanying consolidated financial statements at fair value consist only of SCL Health's units of the CIP. Units are measured at fair value based upon their net asset value. Following are descriptions of each asset class held within the CIP:

Absolute return: This is a fund of funds with investments in private equity, structured credit, real estate, asset-based lending, and distressed assets.

Core hedge funds: The hedged equity pool consists of managers whose long-term target is an equity-like return with substantially less volatility than the equity market. The underlying managers may use leverage and short-term securities in implementing their investment style. The hedged equity pool may utilize separate accounts but will generally consist of pooled vehicles, including mutual funds and limited partnerships.

Domestic equity: The domestic equity pool invests in securities listed on the various stock exchanges located in the United States (NYSE, AMEX, NASDAQ, etc.). Foreign companies with domestically issued securities American depository receipts are allowed in the domestic equity pool. The domestic equity pool may consist of pooled vehicles and/or separate accounts.

Domestic fixed income: The fixed-income pool invests in a variety of fixed-income instruments ranging in duration from 0 to 30 years or more. The aggregate duration of the pool is generally five to seven years or less. The fixed-income pool may consist of pooled vehicles and/or separate accounts.

Global equity: The global equity pool invests in securities listed on the major exchanges around the world. Global equity securities may be domiciled in developed and emerging markets and will expose the holders of this fund to currency risk as the equities may be denominated in the local currency of the market in which they trade. The global equity pool consists of pooled vehicles only when custodial and administrative costs associated with separate accounts prove inefficient.

Opportunistic funds: The private equity/opportunistic pool consists of managers that seek to take advantage of specific opportunities, generally in the private markets. The pool will generally make investments with limited liquidity, sometimes known as lock-up funds. The opportunistic pool consists of pooled vehicles only and will usually be accessed through limited partnerships.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Real return: The real return pool consists of a variety of inflation-hedging strategies, including (but not limited to) public and private real estate, inflation-linked bonds, and commodities and commodity-linked equities. The real return pool consists of pooled vehicles only when custodial and administrative costs associated with separate accounts prove inefficient.

Tactical asset allocation: The tactical asset allocation pool consists of managers that are allowed to purchase cash, fixed-income, and equity securities across the globe. The tactical asset allocation pool consists of pooled vehicles only when custodial and administrative costs associated with separate accounts prove inefficient.

Master Limited Partnership (MLP): MLPs are partnerships that derive greater than 90% of their income from real estate, natural resources, and commodities. They are traded on public exchanges like equity securities. This pool invests largely in commodity-related companies and generally consists of pooled vehicles but may include separate accounts when it is most efficient.

Global infrastructure: Global infrastructure consists of equities listed on exchanges in the U.S., developed international, and emerging markets. However, exposure is generally more in the developed economies due to stronger regulations and property rights. The exposure is generally a more defensive, low-volatility return stream given the companies in the portfolio own infrastructure vital to their particular region or industry. Common types of companies include, but are not limited to, toll roads, airports, public utilities, and broadcast towers.

SCL Health invests funds in excess of projected operating requirements. Trustee-held funds represent the unspent proceeds from bond financings. Self-insured risks funds are set aside by SCL Health to satisfy insurance claims and other related expenditures. Investments in equity and debt securities are measured at fair value.

Investments are considered to be trading securities. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in excess of revenue over expenses unless the income or loss is restricted by donor or law. Gains and losses with respect to disposition of marketable securities are based on the specific-identification method. Investment returns related to temporarily and permanently restricted net assets are added or deducted from the appropriate net asset balance based on donors' intent.

Derivative Financial Instruments

SCL Health investment fund managers use derivative financial instruments in the investment portfolio to moderate changes in value due to fluctuations in financial markets. SCL Health has not designated its derivatives related to marketable securities as hedges, and the change in fair value of these derivatives is recognized as a component of investment income.

SCL Health uses interest rate swap contracts in managing its capital structure. SCL Health recognizes these derivative instruments as either assets or liabilities in the consolidated balance sheets at fair value. The presentation of changes in the fair value (e.g., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and the type of hedging relationship.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

For a derivative instrument that is designated and qualifies as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of unrestricted net assets and reclassified into excess of revenues over expenses in the same period or periods during which the cash flows of the hedged transaction are settled. The ineffective portion is recorded in the excess of revenues over expenses in the current period. If the hedging relationship ceases to be highly effective or it becomes probable that an expected transaction will no longer occur, subsequent gains or losses on the derivatives are recorded in excess of revenues over expenses and any cumulative amounts included in unrestricted net assets are amortized over the life of the derivative and included in excess of revenues over expenses.

Land, Buildings, and Equipment

Land, buildings, and equipment are stated at cost, if purchased, or if donated at fair value at the date of donation. Improvements and replacements are capitalized, and repairs and maintenance are expensed when incurred. Interest incurred in connection with borrowings to finance major construction or expansion of facilities is capitalized during the construction period and subsequently amortized over the lives of the related assets. Depreciation expense is calculated using the straight-line method, which allocates the cost of tangible property equally over its estimated life. Buildings are depreciated over estimated useful lives of 5 to 80 years, land improvements over 2 to 50 years, and equipment over 3 to 30 years. As of December 31, land, buildings, equipment, and accumulated depreciation were as follows:

	<u>2017</u>	<u>2016</u>
	<i>(In Millions)</i>	
Land	\$ 149.9	\$ 145.5
Buildings	2,108.9	2,039.9
Land improvements	169.3	140.9
Equipment	1,503.9	1,461.7
Construction-in-progress	109.4	98.7
	<u>4,041.4</u>	<u>3,886.7</u>
Less accumulated depreciation	1,990.5	1,861.1
	<u>\$ 2,050.9</u>	<u>\$ 2,025.6</u>

Asset Impairment

SCL Health considers whether indicators of impairment are present or performs the necessary test to determine whether the carrying value of an asset is appropriate. Impairment charges are recognized in income from continuing operations at the time the impairment is identified. See Note 3 for discussions of asset impairment related to discontinued operations.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Investments in Joint Ventures

SCL Health accounts for investments in joint ventures using the equity or cost method, depending on the nature of the investment and extent of influence or ownership by SCL Health.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by SCL Health has been limited by donors to a specific time period or purpose. These assets relate primarily to gifts restricted for capital expenditures, research, or health care services.

Permanently restricted net assets have been restricted by donors to be maintained by SCL Health in perpetuity, the income from which is expendable based on donor intent.

Reclassifications of temporarily and permanently restricted net assets on the consolidated statements of changes in net assets represent donor changes or subsequent clarification of the intended purpose of previously recorded contributions or modifications based on donor direction.

Contributions, Bequests, and Grants

Donors' unconditional pledges to give cash and other assets are reported at fair value at the date the promise is received. Donors' conditional pledges to give, and indications of intentions to give, are reported at fair value at the date the condition is satisfied. All unrestricted contributions, bequests, and grants are included in excess of revenues over expenses. Contributions, bequests, and grants are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is satisfied (as to either time or purpose), temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Resources temporarily restricted by donors for additions to land, buildings, and equipment whose purposes have been met are recorded as net assets released for capital acquisitions in the consolidated statements of changes in net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated statement of operations.

SCL Health is subject to the Uniform Prudent Management of Institutional Funds Acts, as separately enacted in Kansas, Colorado, and Montana. Collectively, these statutes establish requirements for the management, investment, and expenditure of endowed funds. SCL Health has adopted investment and spending policies for endowment assets that attempt to provide a stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under these policies, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of their relevant benchmarks while assuming a reasonable level of investment risk.

As of December 31, 2017 and 2016, the permanently restricted endowment net assets were \$21.2 million and \$23.8 million, respectively.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates.

Operating and Performance Indicators

SCL Health's primary mission is to meet the health care needs of its service areas through a broad range of general and specialized health care services, including inpatient, acute care, outpatient, physician, and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities.

The activities of SCL Health are primarily related to providing health care services, and, accordingly, expense information by functional classification is not used as a basis for measuring performance. Furthermore, since substantially all resources are derived from providing health care services, similar to that provided by a business enterprise, the following indicators are considered important in evaluating how well management has discharged its stewardship responsibilities:

Operating Indicator (income from continuing operations) – Includes all unrestricted revenue, gains, and other support; equity income or loss of unconsolidated health care subsidiaries; and expenses directly related to the recurring and ongoing health care operations during the reporting period. Other activities that result in gains or losses peripheral to SCL Health's primary mission are considered to be non-operating. The operating indicator excludes income tax expense, investment income or losses (including changes in unrealized gains and losses on investments), losses on early extinguishment of debt, Mission Fund expenditures, and gains and losses deemed by management to not be directly related to providing health care services, including contributions or costs associated with the acquisition and disposition of health care entities.

Performance Indicator (excess of revenues over expenses attributable to SCL Health) – Includes income from continuing operations and non-operating gains and losses. The performance indicator excludes the amortization of accumulated losses on interest rate swaps, income or loss attributable to non-controlling interests of joint ventures, pension-related charges other than net periodic pension costs, contributions for capital expenditures, and the results of discontinued operations.

Non-controlling Interests in Subsidiaries

SCL Health attributed an excess of revenue over expenses of \$2.6 million and a deficit of revenue over expenses of \$1.8 million for the years ended December 31, 2017 and 2016, respectively, to the non-controlling interests based on the contractual terms of joint ventures and the ownership percentage of the non-controlling interests in certain of the consolidated subsidiaries. These amounts are reflected in unrestricted net assets in the accompanying consolidated balance sheets, net of distributions.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Income Taxes

SCL Health and its hospital, foundation, and clinic Affiliates have been determined to be exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as organizations described in Section 501(c)(3). Income tax expenses in the accompanying consolidated statements of operations relate to wholly owned for-profit entities.

On December 22, 2017, the Tax Cuts and Jobs Act (the Tax Act) was enacted. The Tax Act reduces the U.S. federal corporate tax rate from 35% to 21%, provides for a new excise tax on certain compensation of exempt organizations over \$1 million, and requires the separate calculation of unrelated business taxable income for each trade or business carried on.

As of December 31, 2017, SCL Health has not completed its accounting for the tax effects of the Tax Act. However, SCL Health has made reasonable estimates of the impact of the changes, which were determined to be immaterial. SCL Health will update provisional amounts as additional analysis is completed, and as it gains a more thorough understanding of the Tax Act and receives guidance from the Internal Revenue Service on how the new provisions apply to exempt organizations and taxable affiliates.

Discontinued Operations

A disposal transaction qualifies for reporting as a discontinued operation if all of the following criteria are met: (i) the disposal group is a component of an entity; (ii) the component meets the held-for-sale criteria, is disposed of by sale, or is disposed of other than by sale; and (iii) the component represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. In the period that a component meets such criteria, its results of operations for current and prior periods are reclassified to discontinued operations, and the assets and liabilities of the related disposal group are segregated on the consolidated balance sheets. See Note 3 for information regarding SCL Health's discontinued operations.

Reclassifications

Certain balances in the 2016 consolidated financial statements have been reclassified to conform to the current year presentation. The effect of such reclassifications did not change total net assets, income from continuing operations, or excess of revenue over expenses.

Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which changes certain financial statement requirements including how restricted resources are presented on the face of the financial statements, how certain expenses are reported, and requires disclosure of information about available resources and liquidity. ASU 2016-14 is effective for years beginning after December 15, 2017. SCL Health has not yet determined the effects that adoption of ASU 2016-14 may have on its consolidated financial statements.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which amends the existing accounting standards for leasing accounting, including requiring lessees to recognize most leases on the consolidated balance sheets and making targeted changes to lessor accounting. ASU 2016-02 will be effective for annual periods beginning after December 15, 2018, with early adoption permitted. The new leases standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. SCL Health has not yet determined the effects that adoption of ASU 2016-02 may have on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which provides new recognition, measurement, and disclosure guidance for certain financial instruments. This ASU is effective for SCL Health on December 31, 2019; however, early adoption of a provision that eliminates the required disclosure of the fair value of debt instruments is permitted. SCL Health has chosen to early adopt that provision effective December 31, 2017.

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, which eliminates the requirement to categorize within the fair value hierarchy investments whose fair values are measured at net asset value using the practical expedient in Accounting Standards Codification (ASC) 820. SCL Health adopted the provisions of this ASU effective December 31, 2017.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and has subsequently issued supplemental and/or clarifying ASUs (collectively, ASC 606). ASC 606 outlines a five-step framework that intends to clarify the principles for recognizing revenue and eliminate industry-specific guidance. In addition, ASC 606 revises current disclosure requirements in an effort to help financial statement users better understand the nature, amount, timing, and uncertainty of revenue that is recognized. ASC 606 will be effective for SCL Health beginning on January 1, 2018. SCL Health is in process of finalizing analyses of its various revenue streams and evaluating Medicaid provider fee programs in the states it operates. SCL Health plans to use a portfolio approach to estimate variable consideration for patient service contracts and believes the most significant impact will be to the presentation of the provision for bad debts in the statement of operations. Under the new revenue standard, amounts previously reported as provision for bad debts will be recorded as a direct reduction to revenues. SCL Health expects to adopt the new standard using the full retrospective application and does not believe the adoption will have a significant impact on its recognition of net revenues for any period.

3. Discontinued Operations

On May 25, 2016, the Board of Directors of SCL Health authorized and directed management to explore the divestiture of the hospital and related assets of St. Francis Health Center, Inc., St. Francis physician clinics, and Medicare (collectively referred to as SFT) located in Topeka, Kansas. On November 1, 2017, SCL Health divested St. Francis Health Center, Inc., St. Francis physician clinics and Medicare. In accordance with ASC 205-20, *Presentation of Financial Statements – Discontinued Operations*, the results of operations associated with SFT have been reported as discontinued operations and are included in the accompanying consolidated statements of changes in net assets.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

3. Discontinued Operations (continued)

As part of such divestiture, St. Francis Health Center, Inc. withdrew as a Restricted Affiliate under the Master Trust Indenture (as amended and restated), dated as of January 1, 1994, between SCL Health and The Bank of New York Mellon Trust Company, N.A., as master trustee.

Relevant financial information for SFT as of and for the years ended December 31 are as follows:

	2017	2016
	<i>(In Millions)</i>	
Balance Sheets		
Accounts receivable:		
Patient	\$ —	\$ 28.6
Other	—	5.1
Inventory	—	5.1
Other assets	—	6.9
Land, buildings, and equipment, net	—	39.5
Total assets held for sale	<u>\$ —</u>	<u>\$ 85.2</u>
Accounts payable	\$ —	\$ 7.4
Accrued salaries, wages, and benefits	—	9.1
Other accrued expenses	—	0.9
Total liabilities held for sale	<u>\$ —</u>	<u>\$ 17.4</u>
	2017	2016
	<i>(In Millions)</i>	
Statements of Operations		
Operating revenue:		
Net patient service revenue	\$ 175.7	\$ 222.8
Other operating revenue	5.1	5.2
Total operating revenue	<u>180.8</u>	228.0
Operating expenses:		
Salaries and wages, and associate benefits	101.8	126.3
Other operating expenses	101.7	132.9
Depreciation and amortization	—	8.5
Asset impairment	49.1	36.6
Total operating expenses	<u>252.6</u>	304.3
Loss from discontinued operations	(71.8)	(76.3)
Non-operating losses	(0.3)	(1.0)
Total loss on discontinued operations	<u>\$ (72.1)</u>	<u>\$ (77.3)</u>

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

3. Discontinued Operations (continued)

The asset impairment of \$49.1 million and \$36.6 million for the years ended December 31, 2017 and 2016, respectively, was applicable to SFT's fixed assets and was estimated based on the difference between the anticipated sales price of SFT and the carrying value of the fixed assets at December 31, 2017 and 2016, respectively.

The consolidated statements of cash flows include use of cash of \$4.7 million and \$0.2 million of operating, investing, and financing activities related to discontinued operations for the years ended December 31, 2017 and 2016, respectively.

4. Charity Care

SCL Health has a mission to care for those who are poor and vulnerable and provides charity care to patients deemed to be either financially or medically indigent. Policies have been established that define charity care and provide guidelines for assessing a patient's ability to pay. Evaluation procedures for charity care qualification have been established for those situations when previously unknown financial circumstances are revealed or when incurred charges are significant when compared to the individual patient's income and/or net assets.

The cost to provide charity care measured using the consolidated cost to charge ratio was \$35.3 million and \$36.3 million for 2017 and 2016, respectively. The ratio of cost to charges is calculated based on SCL Health's total operating expenses less other non-patient operating revenue divided by gross patient service revenue.

In addition to traditional charity care services, SCL Health has a financial assistance policy that offers discounted services to uninsured patients who do not otherwise qualify for charity. The payments expected from patients are based on rates negotiated with managed care plans, with discounts determined on a sliding scale tied to the federal poverty level. SCL Health's financial assistance policy prohibits the use of collection practices that do not respect the dignity of its patients. Liens on principal residences may only be used when there is clear evidence of the patient's ability to pay, may not be used to force foreclosure or sale, and must be approved by the Affiliate's Board Finance Committee.

SCL Health benefits its communities in a variety of ways. To improve the health status of citizens in the communities served, it provides numerous community education programs that alert the public to various health problems and how they can be addressed. SCL Health offers health promotion and wellness programs and provides specific health care services and programs for senior citizens. Each of these programs helps contain the growth of community health care costs through prevention and positive intervention. SCL Health has established a Mission Fund at each Affiliate. Earnings from the funds are available to support these charitable services and programs.

SCL Health addresses problems of the poor in the communities by providing services such as health fairs and screenings at no cost or at substantially reduced rates. It provides prenatal education classes especially for low-income persons and transportation for those who otherwise would have no access to medical services. SCL Health also supports organizations that provide other outreach programs for the poor, including the stand-alone clinics that serve only the medically underserved populations in their service areas.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

4. Charity Care (continued)

SCL Health sponsors three stand-alone clinic affiliates (the Clinics) specifically for those individuals who have no other source of health care assistance. Generally, the Clinics do not serve persons with Medicare or any kind of private health insurance. The majority of funding for the Clinics is generated from individual contributions, donations, foundations, grants, and in-kind services. The Clinics create access to health care for those individuals without access, provide channels for physicians to reach the poor, and make a difference in the communities where they are established.

5. Net Patient Service Revenue

A significant portion of SCL Health's services are provided to patients under agreements with Medicare, Medicaid, private insurance companies, and other agencies. Such contracts provide for payment or reimbursement to SCL Health at other-than-standard charges. Estimated settlements have been reflected in the accompanying consolidated balance sheets for differences between interim payments and the total payments to be received under the contracts.

The administrative procedures related to the cost reimbursement programs in effect generally preclude final determination of amounts due or payable until cost reports are audited or otherwise reviewed and settled upon by the applicable administrative agencies. Normal estimation differences between final settlements and amounts accrued in previous years are reported as current year contractual adjustments.

Net patient service revenue as reflected in the accompanying consolidated statements of operations consists of the following:

	2017	2016
	<i>(In Millions)</i>	
Gross patient service charges:		
Inpatient charges	\$ 4,703.1	\$ 4,355.6
Outpatient charges	4,249.2	3,778.7
Total gross patient service charges	8,952.3	8,134.3
Deductions from patient service charges:		
Contractual allowances and other	6,231.1	5,541.7
Charity allowances	131.1	129.7
Provision for bad debts	51.7	61.6
Total deductions from gross patient service charges	6,413.9	5,733.0
Net patient service revenue	\$ 2,538.4	\$ 2,401.3

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, or investigations.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

5. Net Patient Service Revenue (continued)

The primary sources of consolidated net patient service revenue before the provision for bad debts include Medicare, state-administered Medicaid programs, contracted rate payors (including health maintenance organizations and preferred provider organizations), commercial insurers, self-paying patients, and other sources. The following information provides consolidated net patient service revenue by payor for the years ended December 31:

	2017		2016	
	<i>(In Millions)</i>			
Medicare	\$ 780.1	30%	\$ 734.1	30%
Medicaid	415.9	16	356.1	14
Managed care, commercial, and other	1,347.0	52	1,322.0	54
Self-pay	47.1	2	50.7	2
	<u>\$ 2,590.1</u>	<u>100%</u>	<u>\$ 2,462.9</u>	<u>100%</u>

Revenue from Kaiser Permanente (see Note 12) represented approximately 23.4% and 23.2% of SCL Health's net patient service revenue for the years ended December 31, 2017 and 2016, respectively. Approximately 76.0% of SCL Health's net patient service revenue is derived from Affiliates doing business in the state of Colorado.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimates may change. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The Centers for Medicare & Medicaid Services have made inquiries regarding certain reimbursements claimed by SCL Health. SCL Health has adopted internal organizational responsibility and compliance programs to address these concerns and seeks to proactively respond to these requests. SCL Health does not expect that the ultimate resolution of these inquiries will be material to its consolidated financial statements.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

6. Investments and Assets Limited as to Use

The majority of SCL Health's investments are composed of its pro rata share of the CIP's funds held for participants and certain other investments such as those investments held and managed by foundations and the captive insurance company. Investments and assets limited as to use, stated at fair value, were as follows:

	2017	2016
	<i>(In Millions)</i>	
Held in CIP:		
Cash and cash equivalents	\$ 68.2	\$ 56.1
Domestic fixed income	573.9	427.4
Global equity	651.8	425.1
Real return	182.5	182.8
Tactical asset allocation	–	126.2
Core hedge funds	95.2	87.5
Global infrastructure	97.0	81.9
MLP	75.8	81.6
Domestic equity	95.2	66.8
Opportunistic funds	48.8	43.2
Real estate	37.5	37.5
Absolute return	5.6	7.3
	1,931.5	1,623.4
Investments held outside of the CIP	92.0	85.2
	\$ 2,023.5	\$ 1,708.6

SCL Health's interest in the CIP represented 81% and 79% of the funds held for participants in the CIP at December 31, 2017 and 2016, respectively. The real estate investments are not held in units and are wholly owned by SCL Health.

SCL Health's investments are exposed to various kinds and levels of risk. Fixed-income securities expose SCL Health to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed-income securities is affected, particularly those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligation. Liquidity risk is affected by the willingness of market participants to buy and sell given securities. SCL Health's investments are diversified across a broad range of asset classes, durations, and funds to avoid concentrations of risk in any particular company, region, or industry.

Equity securities expose SCL Health to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets, both foreign and domestic. Performance risk is that risk associated with a company's operating performance. Liquidity risk, as previously defined, tends to be higher for foreign equities and equities related to small capitalization companies.

The real estate investments, opportunistic investments, and absolute return funds present similar risks to all of the traditional investments, with some additional risks. Due to the fact that these investments are invested through limited partnerships, private real estate investment trusts, insurance separate accounts, or other limited-access-type vehicles, pricing is infrequent. These investments may also employ leverage that may lead to additional risk of loss. Although

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

6. Investments and Assets Limited as to Use (continued)

these investments are diversified by region and property type, they may at times have concentrations in a particular region or property type, which may cause additional risk. The real estate investment funds are redeemable on a quarterly basis with 60 to 90 days' notice. Opportunistic funds have restrictions on liquidity withdrawals. Interim liquidity in opportunistic funds is only available after the investments realize profits. As of December 31, 2017, SCL Health has committed \$152.9 million to opportunistic funds and has funded \$107.9 million of this commitment. In addition, SCL Health had given full redemption notices to investment managers in the absolute return funds and two of the core hedge fund managers with \$5.6 million still remaining in the Absolute return funds as of December 31, 2017.

For the years ended December 31, 2017 and 2016, investment-related expenses of \$4.4 and \$3.8 million, respectively, were netted against investment income. The composition of non-operating net investment income is as follows for the years ended December 31:

	<u>2017</u>	<u>2016</u>
	<i>(In Millions)</i>	
Interest and other investment income	\$ 31.2	\$ 28.3
Realized and unrealized gains, net	174.4	71.2
	<u>\$ 205.6</u>	<u>\$ 99.5</u>

7. Capital Structure

Long-term debt consists of the following:

	<u>Annual Interest Rates</u>	<u>2017</u>	<u>2016</u>
		<i>(In Millions)</i>	
Tax-exempt bond issues:			
2016, due through December 2045	Variable rate, 0.99% and 0.71%	\$ 222.0	\$ 222.0
2013, due through January 2044	4.00% to 5.50%	300.0	300.0
2011, due through January 2039	Variable rate, 1.40% and 0.88%	56.4	57.5
2010, due through January 2040	3.50% to 5.25%	694.1	717.0
Total under the SCL Health MTI		1,272.5	1,296.5
PVMC mortgage (HUD-insured)		75.2	79.2
Other notes and capital leases		3.9	4.1
		<u>1,351.6</u>	<u>1,379.8</u>
Original issue premium, net		10.0	11.2
Unamortized debt issuance costs		(10.5)	(11.1)
Current maturities of long-term debt		(177.4)	(176.1)
		<u>\$ 1,173.7</u>	<u>\$ 1,203.8</u>

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

7. Capital Structure (continued)

SCL Health is the sole member of an Obligated Group, of which the Restricted Affiliates are included under the terms of an MTI amended and restated as of January 1, 1994. Under the terms of the MTI, debt can be incurred for which the Obligated Group is jointly and severally liable. As of December 31, 2017, there were guarantees of indebtedness by SCL Health outstanding under the MTI of \$9.8 million (see Note 14). The Obligated Group has agreed to certain covenants, including, among other things, a specified debt service coverage ratio and debt-to-capitalization ratio, a restriction on certain types of additional indebtedness, and a restriction on asset dispositions in excess of specified amounts. The consolidated results of the Obligated Group and Restricted Affiliates are used to determine compliance with certain covenants of the MTI. As of December 31, 2017 and 2016, SCL Health was in compliance with all MTI covenants.

On November 17, 2017, SCL Health established revolving lines of credit with Bank of America, N.A. and Wells Fargo Bank, N.A. totaling \$200 million with three-year terms. As of December 31, 2017, there were no outstanding balances drawn on the lines of credit.

On June 15, 2016, SCL Health executed a new five-year private placement agreement for \$57.5 million of outstanding 2011A Colorado Health Facility Authority tax-exempt variable rate revenue bonds with Bank of America.

On June 1, 2016, SCL Health established a defeasance escrow with respect to Series 2010A Kansas Development Finance Authority tax-exempt bonds allocable to St. Francis projects and other Kansas projects (approximately \$143.2 million in total aggregate principal amount) at a cost to SCL Health of approximately \$163.7 million, funded from SCL Health's cash fund balances (including cash made available by liquidating investment holdings). The defeasance resulted in a \$16.5 million loss on early extinguishment of debt.

On May 12, 2016, SCL Health issued the Series 2016A, 2016B, 2016C, and 2016D Colorado Health Facilities Authority tax-exempt variable rate revenue bonds in a par amount of \$222.0 million. Proceeds of the Series 2016 bonds will be used to finance qualified capital expenditures at SJH in Denver, Colorado, and St. Mary's Hospital & Medical Center in Grand Junction, Colorado.

On May 11, 2016, SCL Health used cash to defease the \$220.0 million outstanding par amount of the Colorado Series 2003A, Kansas Series 2012A, Montana Series 2014A, and Colorado Series 2014B variable rate tax-exempt bonds, resulting in a \$0.7 million loss on early extinguishment of debt.

On May 1, 2005, PVMC entered into a \$118.4 million loan agreement with Adams County, Colorado, to fund the costs of acquiring, constructing, and equipping a replacement hospital facility. PVMC's obligation to repay its debt under the loan agreement is evidenced by a Deed of Trust Note payable to the order of the trustee and secured by a mortgage on the PVMC's fee simple interest in land, buildings, and improvements, along with the PVMC's fixtures, furnishings, and equipment. The mortgage is insured by the U.S. Department of Housing and Urban Development (HUD) acting by and through the Commissioner of the Federal Housing Administration under Section 242 of Title II of the National Housing Act and the regulations and rules thereunder. The financing arrangement through HUD requires the PVMC to comply with certain regulatory requirements, including maintenance of a mortgage reserve fund balance of \$12.8 million. As of December 31, 2017, the mortgage reserve fund was at \$12.9 million.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

7. Capital Structure (continued)

The Series 2016B and 2016D variable rate demand bonds are backed by a Standby Bond Purchase Agreement with Wells Fargo. The Standby Bond Purchase Agreement supporting the 2016 Series B and D (CO) bonds expires on May 1, 2019. In the event that bonds bearing interest at a weekly rate are not successfully remarketed or if funds are not available for remarketing, Wells Fargo will pay the purchase price for debt that is tendered.

Scheduled principal repayments on long-term debt (excluding original issue premium) are as follows:

<u>Years Ending December 31</u>	<u>Scheduled</u>	<u>Scheduled With Variable Rate Classified as Current</u>
2018	\$ 29.5	\$ 177.4
2019	31.7	68.7
2020	33.2	70.2
2021	34.1	34.1
2022	38.1	38.1
Thereafter	1,185.0	963.1
	<u>\$ 1,351.6</u>	<u>\$ 1,351.6</u>

8. Derivative Instruments

SCL Health has entered into three interest rate swaps, which qualified for hedge accounting treatment until May 12, 2016. Details of the interest rate swaps are outlined below:

Notional amount	\$22,140,000	\$60,000,000	\$22,140,000
Fixed annual payment rate	3.789%	4.215%	3.180%
Variable receiver rate	SIFMA rate	SIFMA rate	68% of LIBOR
Termination date	December 1, 2023	December 1, 2031	December 1, 2023
Reset	Weekly	Weekly	Monthly
Settlement	Monthly	Monthly	Monthly
Classification	Economic hedge	Economic hedge	Economic hedge
Fair value at December 31, 2017	\$(1.6) million	\$(12.8) million	\$(1.3) million
Fair value at December 31, 2016	\$(2.3) million	\$(13.7) million	\$(2.0) million

Amortization of the accumulated loss on the three swaps was \$2.2 million and \$(1.2) million for the years ended December 31, 2017 and 2016, respectively. The fair value of the swaps is recorded in other non-current liabilities at December 31, 2017 and 2016. The unrecognized accumulated loss on the three swaps was \$16.7 million and \$18.9 million at December 31, 2017 and 2016, respectively. The objective of the hedges was to offset the variability of cash flows due to the repricing of outstanding debt.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

9. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

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

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date. Level 1 primarily consists of financial instruments such as money market securities and listed equities.

Level 2 – Pricing inputs other than quoted prices included in Level 1 that are either directly observable or that can be derived or supported from observable data as of the reporting date. Instruments in this category include certain U.S. government agency and sponsored entity debt securities and interest rate swap contracts.

Level 3 – Pricing inputs include those that are significant to the fair value of the financial asset or financial liability and are not observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of assumptions a market participant would utilize to determine fair value.

The CIP's investments include equities, various fixed-income securities, and alternative investments as detailed in Note 2. As of December 31, 2017, 71% of the CIP's underlying investments were classified as Level 1 and 29% as Level 2. As of December 31, 2016, 75% of the CIP's underlying investments were classified as Level 1 and 25% as Level 2.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

9. Fair Value Measurements (continued)

The fair value of financial assets measured at fair value on a recurring basis was determined using the following inputs as of December 31, 2017:

	Fair Value Measurements at Reporting Date Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	<i>(In Millions)</i>			
Assets				
Investments and assets whose use is limited:				
Cash and cash equivalents	\$ 5.2	\$ 5.2	\$ -	\$ -
U.S. government and agency obligations	12.0	0.8	11.2	-
Corporate debt	3.2	-	3.2	-
Real estate	1.7	-	-	1.7
Mutual funds	51.3	51.3	-	-
Domestic equity	16.4	16.4	-	-
Global/international equity	1.9	1.9	-	-
Held in CIP	1,511.8	-	1,511.8	-
Investments and assets whose use is limited reported at fair value	1,603.5	\$ 75.6	\$ 1,526.2	\$ 1.7
Investments and assets limited as to use reported at net asset value	420.0			
	<u>\$ 2,023.5</u>			
Liabilities				
Obligations under swap contracts	\$ 15.8	\$ -	\$ 15.8	\$ -

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

9. Fair Value Measurements (continued)

The fair value of financial assets measured at fair value on a recurring basis was determined using the following inputs at December 31, 2016:

	Fair Value Measurements at Reporting Date Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	<i>(In Millions)</i>			
Assets				
Investments and assets whose use is limited:				
Cash and cash equivalents	\$ 4.4	\$ 4.4	\$ –	\$ –
U.S. government and agency obligations	12.0	0.9	11.1	–
Corporate debt	3.7	–	3.7	–
Real estate	6.5	–	–	6.5
Mutual funds	45.3	45.3	–	–
Domestic equity	11.7	11.7	–	–
Global/international equity	1.6	1.6	–	–
Held in CIP	1,218.8	–	1,218.8	–
Investments and assets whose use is limited reported at fair value	1,304.0	\$ 63.9	\$ 1,233.6	\$ 6.5
Investments and assets limited as to use reported at net asset value	404.6			
	<u>\$ 1,708.6</u>			
Liabilities				
Obligations under swap contracts	\$ 18.0	\$ –	\$ 18.0	\$ –

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair values of Level 2 securities (primarily holdings within the CIP) were determined based upon the unitized value of CIP holdings and the underlying recent trading activity. The fair values of Level 2 securities related to fixed-income securities were determined through bid prices based on recent trading activity and other relevant information, including market interest rate curves and referenced credit spreads. Estimated prepayment rates, where applicable, are used for valuation purposes provided by third-party services where quoted market values are not available. Level 2 investments also include corporate fixed-income, government bonds, and mortgage and asset-backed securities. The fair values of the interest rate swap contracts are determined based on the present value of expected future cash flows using discount rates approximate with the risks involved. The valuations reflect a credit spread adjustment to the London Interbank

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

9. Fair Value Measurements (continued)

Offered Rate (LIBOR) and Securities Industry and Financial Markets Association (SIFMA) discount curves in order to reflect the credit value adjustment for non-performance risk. The credit spread adjustment is derived from other comparably rated entities' bonds priced in the market. Due to the volatility of the capital markets, there is a reasonable possibility of changes in fair value and additional gains and losses in the near term subsequent to December 31, 2017. Level 3 includes real estate with fair value determined using recent appraisals and purchase data.

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts and pledges receivable, and current liabilities are reasonable estimates of their fair value due to the short-term nature of these financial instruments.

The methods described above may produce a fair value calculation that may not indicate net realizable value or reflect future fair values. Furthermore, while SCL Health believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table is a rollforward of the financial assets classified within Level 3 of the valuation hierarchy defined above:

	<u>Investments</u> <i>(In Millions)</i>
Fair value at January 1, 2016	\$ 5.2
Acquisitions	0.4
Dispositions	(0.5)
Unrealized gains	1.4
Fair value at December 31, 2016	<u>\$ 6.5</u>
Acquisitions	-
Dispositions	(4.8)
Unrealized gains	-
Fair value at December 31, 2017	<u><u>\$ 1.7</u></u>

10. Retirement Plans

Defined-Contribution Plans

SCL Health sponsors a defined-contribution retirement plan (the Defined-Contribution Plan), which is a 401(a) defined-contribution retirement plan that covers substantially all associates. Employer contributions to the plan are based on a percentage of eligible compensation for participating associates and a percentage of participating associates' contributions to a related 403(b) plan. SCL Health funded \$45.2 million and \$42.6 million related to the Defined-Contribution Plan and recognized those amounts in expense during 2017 and 2016, respectively.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

10. Retirement Plans (continued)

SCL Health participates in a supplemental executive retirement plan (SERP) under which the organization contributes to certain associates' retirement accounts. The Compensation Committee determines those associates who are eligible to participate in the SERP. SCL Health expensed \$4.1 million and \$3.8 million related to the SERP during 2017 and 2016, respectively. The SERP liability at December 31, 2017 and 2016, was \$8.1 million and \$8.6 million, respectively, and is included in other long-term liabilities in the accompanying consolidated balance sheets.

Defined-Benefit Plans

SCL Health historically participated in two defined-benefit retirement plans. The first plan relates to SCL Health – Front Range, Inc. (fka Exempla, Inc.). Prior to January 1, 1998, the predecessor to SCL Health – Front Range, Inc. sponsored a defined-benefit pension plan (the SCL Health – Front Range Plan) that covered substantially all of its associates. The benefits were based on years of service and associates' final average compensation. Benefits under the plan have been frozen. SCL Health's funding policy for this plan is to contribute annually the minimum amount under the requirements of the Employee Retirement Income Security Act of 1974, as amended. Contributions are currently intended to provide for benefits attributed to services rendered through January 1, 1998.

The second plan is a single plan with multiple-employer participants that was frozen in 1996 for all participating associates except certain associates of St. James Healthcare. On January 1, 2015, this plan merged with the SCL Health – Front Range Plan, to form a single plan known as the SCL Health Consolidated Retirement Plan (the Plan).

The following sets forth the Plan's funded status and accrued pension liability, as of December 31, as actuarially determined:

	2017	2016
	<i>(In Millions)</i>	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	\$ 347.1	\$ 361.0
Service cost	0.4	0.2
Interest cost	11.3	12.1
Actuarial loss	13.7	5.5
Benefits paid	<u>(23.3)</u>	<u>(31.7)</u>
Projected benefit obligation at end of year	349.2	347.1
Change in plan assets		
Fair value of plan assets at beginning of year	329.1	337.3
Actual return on plan assets	43.3	21.6
Contributions	0.8	4.0
Benefits paid	<u>(23.3)</u>	<u>(31.7)</u>
Expenses paid	<u>(1.3)</u>	<u>(2.1)</u>
Fair value of plan assets at end of year	<u>348.6</u>	<u>329.1</u>
Accrued pension liability	<u>\$ (0.6)</u>	<u>\$ (18.0)</u>

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

10. Retirement Plans (continued)

The actuarial loss of \$13.7 million for the year ended December 31, 2017, was primarily driven by the decrease in the discount rate, which increased the pension benefit obligation (PBO) liability by \$15.7 million. In 2016, SCL Health adopted the new mortality table (MP-2015). The actuarial loss of \$5.5 million for the year ended December 31, 2016, was driven primarily by the adoption of the MP-2015 and change in the discount rate.

Included in unrestricted net assets at December 31 are the following amounts that have not yet been recognized in net periodic pension cost:

	<u>2017</u>	<u>2016</u>
	<i>(In Millions)</i>	
Unrecognized actuarial losses	\$ 119.2	\$ 32.7
Unrecognized prior service costs	<u>(1.6)</u>	<u>(2.2)</u>
	<u>\$ 117.6</u>	<u>\$ 130.5</u>

Changes in plan assets and benefit obligations recognized in unrestricted net assets include the following:

	<u>2017</u>	<u>2016</u>
	<i>(In Millions)</i>	
Unrecognized actuarial (gains) losses	\$ (9.3)	\$ 6.0
Amortization of actuarial losses	<u>(4.2)</u>	<u>(3.6)</u>
Amortization of prior service costs	<u>0.6</u>	<u>0.6</u>
	<u>\$ (12.9)</u>	<u>\$ 3.0</u>

The prior service cost and actuarial losses included in unrestricted net assets and expected to be recognized in net periodic pension benefit during the year ending December 31, 2018, are \$4.1 million.

	<u>2017</u>	<u>2016</u>
	<i>(In Millions)</i>	
Components of net periodic benefit cost		
Service cost	\$ 2.6	\$ 2.2
Interest cost	<u>11.3</u>	<u>12.1</u>
Expected return on plan assets	<u>(20.7)</u>	<u>(22.1)</u>
Amortization of prior service cost	<u>(0.6)</u>	<u>(0.6)</u>
Amortization of actuarial losses	<u>4.2</u>	<u>3.6</u>
Net periodic pension benefit	<u>\$ (3.2)</u>	<u>\$ (4.8)</u>

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

10. Retirement Plans (continued)

Weighted-average assumptions used to determine the PBO as of December 31 are as follows:

	<u>2017</u>	<u>2016</u>
Discount rate	3.60%	4.08%
Rate of increase in future compensation levels (age graded)	1.00% to 10.00%	1.00% to 10.00%

Weighted-average assumptions used to determine pension benefit cost for the years ended December 31 are as follows:

	<u>2017</u>	<u>2016</u>
Discount rate PBO	4.08%	4.35%
Discount rate service cost	5.01%	5.10%
Expected return on plan assets	6.25%	6.50%
Rate of increase in future compensation levels (age graded)	2.00% to 8.00%	2.00% to 8.00%

Plan Assets

The expected return on plan assets reflects historical returns and future expectations for returns in each asset class, as well as targeted asset allocation percentages within the portfolio. The investment strategy is of a long-term nature and is intended to ensure that funds are available to pay benefits as they become due and to maximize the trust's total return at an appropriate level of investment risk.

The target and actual asset allocations by asset category are as follows:

<u>Asset Category</u>	2017	<u>Actual Allocation</u>	
	Target Allocation	2017	2016
Cash	2%	4%	–%
Fixed income	65	66	31
Global equity	19	16	32
Core hedge funds	5	5	5
Real return	9	9	17
Domestic equity	–	–	10
Tactical allocation	–	–	5
	100%	100%	100%

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

10. Retirement Plans (continued)

As described in Notes 2 and 7, SCL Health’s investments, which include investments held for its retirement plans, are composed of its pro rata share of the CIP’s funds. Accordingly, the amounts in the tables below reflect the fair value of the defined-benefit plans’ share of each class of investment held in the CIP. All of the investments are categorized as Level 2 for purposes of fair value measurement.

	December 31	
	2017	2016
	<i>(In Millions)</i>	
Assets		
Cash	\$ 13.7	\$ 9.8
Fixed income	229.5	94.8
Global equity	56.7	106.3
Core hedge funds	17.1	15.3
Real return	31.6	55.8
Domestic equity	–	30.0
Tactical allocation	–	17.1
	\$ 348.6	\$ 329.1

Expected Benefit Payments

Expected benefits payments to participants, excluding lump-sum distributions, are as follows (in millions):

2018	\$ 24.2
2019	24.5
2020	24.5
2021	24.5
2022	24.3
2023–2027	114.7

11. Insurance Coverage

SCL Health provides an insurance program for various insurable risks. SCL Health obtains insurance through Leaven Insurance Company, Ltd. (Leaven), a wholly owned subsidiary and captive insurance company, as well as third-party insurers and other self-insured methods.

Aggregate excess umbrella coverage of \$100.0 million and excess claims-made basis professional and general liability coverage of \$100.0 million are obtained through Leaven, which cedes these risks to third-party commercial reinsurers located in the United States, Switzerland, the United Kingdom, and Bermuda. Claims-made general liability coverage provides for a self-insured retention of \$1.0 million per claim up to an annual aggregate of \$3.0 million. Effective October 1, 2010, professional liability coverage provides for a self-insured retention of \$2.0 million per medical incident, \$20.0 million annual aggregate (shared by all insureds), and a buffer layer of insurance is purchased from Leaven with limits of \$3.0 million per medical incident, \$5.0 million annual aggregate. For claims reported prior to October 1, 2010, professional liability coverage provides for a self-insured retention of \$2.0 million per claim,

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

11. Insurance Coverage (continued)

\$7.0 million annual aggregate (these limits are \$2.0 million per claim, \$8.0 million annual aggregate for Front Range and for St. Vincent Healthcare \$3.0 million per claim, \$12.0 million annual aggregate during the period from March 1, 2008 to February 28, 2009; and \$4.0 million per claim, \$14.0 million annual aggregate during the period from March 1, 2009 to September 30, 2010). Primary self-insured professional liability coverage for Kansas affiliates is limited to \$0.2 million per claim up to an annual aggregate of \$0.6 million per affiliate. This and additional statutory coverage purchased from the Kansas Health Care Stabilization Fund will contribute to losses within \$2.0 million, \$20.0 million self-insured retention. SCL Health is self-insured to the extent of the deductible amounts not covered by other insurance. Related expense for this coverage totaled \$16.8 million and \$19.6 million for the years ended December 31, 2017 and 2016, respectively, and has been included in other operating expenses in the accompanying consolidated statements of operations. The loss reserves recorded for estimated self-insured professional and general liability, including estimates of the ultimate costs for both reported claims and claims incurred but not reported, are undiscounted at December 31, 2017, and discounted at an annual rate of 4% at December 31, 2016. The reserves at December 31, 2017, include \$8.2 million as a current liability and \$35.4 million as a non-current liability. The reserves at December 31, 2016, include \$7.1 million as a current liability and \$35.2 million as a non-current liability. Professional and general liability funding is provided through a revocable trust fund.

SCL Health self-insures and funds its obligations for workers' compensation. In connection therewith, SCL Health (excluding Front Range Healthcare) has obtained excess workers' compensation insurance coverage from outside carriers for individual claims in excess of \$750,000. Front Range Healthcare has obtained excess workers' compensation insurance coverage for claims in excess of \$350,000. During 2017 and 2016, \$1.6 million and \$1.1 million, respectively, of workers' compensation expenses were charged to associate benefits expenses in the accompanying consolidated statements of operations. The loss reserves recorded for estimated self-insured workers' compensation, including estimates of the ultimate costs for both reported claims and claims incurred but not reported totaled \$8.7 million and \$9.3 million at December 31, 2017 and 2016, respectively. The reserves at December 31, 2017, include \$2.4 million as a current liability and \$6.3 million as a non-current liability. The reserves at December 31, 2016, include \$2.9 million as a current liability and \$6.4 million as a non-current liability.

SCL Health offers an associate benefit package to all eligible associates and their dependents. The majority of these benefits are self insured and are provided through the SCL Health Employee Benefit Plan (the Benefit Plan). Contributions to the Benefit Plan are made in amounts determined in accordance with the recommendations of an independent actuary based on past claims experience and other factors. During 2017 and 2016, \$108.1 million and \$133.4 million, respectively, were charged to associate benefits expenses in the accompanying consolidated statements of operations. The loss reserves recorded for the estimated self-insured Benefit Plan, including estimates of the ultimate costs for both reported claims and claims incurred but not reported, totaled \$11.0 million and \$15.0 million at December 31, 2017 and 2016, respectively, and represent a current liability.

SCL Health is presently not aware of any unasserted casualty, professional liability, workers' compensation, or health and dental benefit claims that would have a material adverse impact on the accompanying consolidated financial statements.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

12. Relationship with Kaiser Permanente

Effective July 1, 2013, SCL Health entered into a three-year renewable/evergreen provider services agreement on behalf of GSMC with a Kaiser Permanente affiliate, specifying the terms under which GSMC provides hospital services to Kaiser Permanente. Among other things, the agreement specifies payment terms and termination conditions, including annual rate inflators, volume guarantees for outpatient surgery cases in which rates increase in the event Kaiser does not meet the volumes threshold, and exclusive designation for inpatient services based on a designated geographic service area. This agreement requires periodic renegotiations of rates. The most recent update occurred on January 1, 2018.

In January 2012, SJH entered into a ten-year provider services agreement (the Agreement) with a Kaiser Permanente affiliate. Among other things, the Agreement specifies payment terms and conditions, annual rate inflators, and volume guarantees that provide for additional rate adjustments in the event Kaiser Permanente admission volumes increase or decrease from the specified baseline.

13. Relationship with National Jewish Health

On June 25, 2014, SCL Health signed a joint operating agreement (JOA) with National Jewish Health (NJH). Under the terms of the JOA, SJH and NJH manage and operate their respective clinical operations as a combined business enterprise. SCL Health and NJH each retain ownership of their respective assets, liabilities, equity, revenues, and expenses of their businesses. However, the income/loss of the combined clinical operations is shared 75% with SCL Health and 25% with NJH. For the years ended December 31, 2017 and 2016, SCL Health recognized losses on the JOA of \$9.2 million, which are reported in net loss from joint ventures in the accompanying consolidated statements of operations. Additionally, SCL Health recorded a \$7.0 million and a \$3.0 million payable at December 31, 2017 and 2016, respectively.

14. Commitments and Contingencies

SCL Health has guaranteed a total of \$9.8 million for a medical office building in Wyoming, a university in Kansas, an ambulatory surgery center in Colorado, a cancer center in Montana, and other beneficiaries. The fair value of these guarantees is determined using Level 3 measurements, including discounted cash flows and assessments of credit default risks of the counterparty. Due to the immateriality of the fair value of these guarantees, SCL Health has not recorded any related liability at December 31, 2017.

SCL Health has a commitment of \$127.9 million to various construction projects in progress. As of December 31, 2017, SCL Health has spent \$44.6 million on these projects and has reflected this in land, buildings, and equipment, net.

SCL Health has a \$210.0 million commitment for capital investments to PVMC over the next eight years, of which \$36.2 million has been satisfied as of December 31, 2017.

Sisters of Charity of Leavenworth Health System, Inc.

Notes to Consolidated Financial Statements (continued)

14. Commitments and Contingencies (continued)

SCL Health's rent expense under operating leases was \$27.6 million and \$32.1 million for the years ended December 31, 2017 and 2016, respectively. Scheduled non-cancelable operating lease payments during the next five years and thereafter are as follows (in millions):

2018	\$ 21.9
2019	18.6
2020	13.0
2021	10.8
2022	5.6
Thereafter	7.6
	<u>\$ 77.5</u>

15. Subsequent Events

SCL Health evaluated events and transactions occurring subsequent to December 31, 2017 through May 4, 2018, the date of issuance of the accompanying consolidated financial statements.

Supplementary Information



Ernst & Young LLP
Suite 3300
370 17th Street
Denver, CO 80202

Tel: +1 720 931 4000
Fax: +1 720 931 4444
ey.com

Report of Independent Auditors on Supplementary Information

The Board of Directors
Sisters of Charity of Leavenworth
Health System, Inc.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying financial and operating information, sources of patient revenue, capitalization ratio, debt service coverage requirements, financial performance, and utilization are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information, except for that portion marked “unaudited,” has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information, except for that portion marked “unaudited” on which we express no opinion, is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst & Young LLP

May 4, 2018

Sisters of Charity of Leavenworth Health System, Inc.

Financial and Operating Information

December 31, 2017

The table below is a summary of the consolidated statements of operations for SCL Health Restricted Affiliates (Restricted) and for SCL Health (Consolidated).

	Year Ended December 31			
	Restricted⁽¹⁾		Consolidated⁽¹⁾	
	2017	2016	2017	2016
	<i>(In Millions)</i>			
Net patient service revenue	\$ 2,222.3	\$ 2,147.2	\$ 2,538.4	\$ 2,401.3
Other revenue	13.8	5.6	77.4	74.4
Total operating revenue	2,236.1	2,152.8	2,615.8	2,475.7
Operating expenses (salaries and wages, associate benefits, and other operating expenses)	1,822.0	1,768.9	2,264.2	2,141.7
Depreciation and amortization	139.8	137.2	155.0	153.6
Interest and amortization	56.5	60.1	59.2	62.7
Total operating expenses	2,018.3	1,966.2	2,478.4	2,358.0
Income from operations	217.8	186.6	137.4	117.7
Investment income, net	198.2	97.0	205.6	99.5
Loss on early extinguishment of debt	–	(17.2)	–	(17.2)
Other gains (losses)	5.4	(0.5)	1.3	(0.5)
Other non-operating losses	(1.0)	(1.4)	(3.5)	(3.4)
Total non-operating gains	202.6	77.9	203.4	78.4
Excess of revenue over expenses	420.4	264.5	340.8	196.1
Less amounts attributable to non-controlling interests	2.6	1.8	2.6	1.8
Total excess of revenue over expenses attributable to SCL Health	\$ 417.8	\$ 266.3	\$ 338.2	\$ 194.3

⁽¹⁾ Excludes discontinued operations.

Sisters of Charity of Leavenworth Health System, Inc.

Capitalization Ratio

December 31, 2017

The following table sets forth the capitalization of SCL Health Restricted Affiliates (Restricted) and SCL Health (Consolidated).

	Year Ended December 31			
	Restricted		Consolidated	
	2017	2016	2017	2016
	<i>(In Millions)</i>			
Long-term debt:				
MTI debt (net of original issue premium and unamortized debt issuance costs)	\$ 1,272.0	\$ 1,296.6	\$ 1,272.0	\$ 1,296.6
Other long-term indebtedness	4.0	4.0	79.1	83.3
Total long-term debt	1,276.0	1,300.6	1,351.1	1,379.9
Less current maturities	(173.2)	(172.0)	(177.4)	(176.1)
Plus variable portion not scheduled	148.0	148.0	148.0	148.0
Net long-term debt	1,250.8	1,276.6	1,321.7	1,351.8
Net assets attributable to SCL Health	2,771.0	2,458.6	2,841.9	2,562.6
Total capitalization	\$ 4,021.8	\$ 3,735.2	\$ 4,163.6	\$ 3,914.4
Percent of net long-term debt to total capitalization	31.1%	34.2%	31.7%	34.5%

Sisters of Charity of Leavenworth Health System, Inc.

Debt Service Coverage Requirements

December 31, 2017

The table below sets forth the debt service coverage of SCL Health Restricted Affiliates (Restricted) and SCL Health (Consolidated).

	Year Ended December 31			
	Restricted⁽¹⁾		Consolidated⁽¹⁾	
	2017	2016	2017	2016
	<i>(In Millions)</i>			
Income available for debt service:				
Excess of revenue over expenses				
attributable to SCL Health	\$ 420.4	\$ 266.3	\$ 338.2	\$ 197.9
Other (gains) losses	(5.4)	0.5	(1.3)	0.5
Loss on early extinguishment of debt	–	17.2	–	17.2
Unrealized gains, net	(127.2)	(64.4)	(136.7)	(71.7)
Depreciation and amortization	139.9	137.2	155.0	153.6
Interest and amortization	56.5	60.1	59.2	62.7
Total income available for debt service	\$ 484.2	\$ 416.9	\$ 414.4	\$ 360.2
Annual debt service requirements ⁽²⁾	\$ 83.0	\$ 99.7	\$ 89.4	\$ 104.8
Actual debt service coverage ratio – all long-term debt ⁽³⁾	5.8x	4.2x	4.6x	3.4x

⁽¹⁾ Excludes discontinued operations.

⁽²⁾ Annual debt service = principal paid + interest paid + 20% of interest and principal for guaranteed debt.

⁽³⁾ Debt service coverage = total income available for debt service/annual debt service.

Sisters of Charity of Leavenworth Health System, Inc.

Financial Performance

December 31, 2017

The following table highlights the financial results for SCL Health Restricted Affiliates (Restricted) and SCL Health (Consolidated).

	Year Ended December 31			
	Restricted ⁽¹⁾		Consolidated ⁽¹⁾	
	2017	2016	2017	2016
Adjusted operating income margin ⁽²⁾	9.7%	9.1%	5.9%	5.1%
Operating income margin ⁽³⁾	17.2%	11.9%	12.1%	7.7%
Return on net assets ⁽⁴⁾	15.1%	10.8%	11.9%	7.7%
Debt service coverage ⁽⁵⁾	5.8x	4.2x	4.7x	3.4x
Days' cash on-hand (excluding self-insured risk funds and trustee-held funds) ⁽⁶⁾	373	332	323	299
Cushion ratio ⁽⁷⁾	23.6x	16.7x	23.7x	17.5x

⁽¹⁾ Excludes discontinued operations, except as otherwise noted.

⁽²⁾ Adjusted operating revenue = net patient service revenue + other operating revenue + net assets released from restrictions.

Adjusted operating income = adjusted operating revenue – total operating expenses.

Adjusted operating income margin = adjusted operating income/adjusted operating revenue.

⁽³⁾ Operating income margin = excess of revenue over expenses/(total operating revenue + (total non-operating gains (losses))).

⁽⁴⁾ Return on net assets = excess (deficit) of revenue over expenses attributable to SCL Health/unrestricted net assets. Unrestricted net assets includes assets and liabilities held for sale.

⁽⁵⁾ Debt service coverage = (excess of revenue over expenses – business acquisitions gains (losses), net – change in unrealized gains (losses), net + depreciation and amortization + interest and amortization)/annual debt service.

⁽⁶⁾ Days' cash on-hand = (cash and cash equivalents + investments – permanently restricted net assets)/((total operating expenses – depreciation and amortization)/cumulative days).

⁽⁷⁾ Cushion ratio = (cash and cash equivalents + investments + trustee-held funds)/annual debt service.

Sisters of Charity of Leavenworth Health System, Inc.

Utilization
(Unaudited)

December 31, 2017

The following table provides utilization statistics for SCL Health Restricted Affiliates (Restricted) and SCL Health (Consolidated).

	Year Ended December 31			
	Restricted⁽¹⁾		Consolidated⁽¹⁾	
	2017	2016	2017	2016
Utilization statistics:				
Licensed beds ⁽²⁾	1,873	1,873	1,971	1,971
Operating (staffed) beds	1,604	1,604	1,674	1,674
Operating bed occupancy	64%	62%	63%	61%
Admissions	78,627	78,028	82,072	81,267
Patient days	372,879	366,263	384,457	376,056
Average length of stay	4.7	4.7	4.7	4.6

⁽¹⁾ Excludes discontinued operations.

⁽²⁾ Includes acute care, psychiatric, hospital-based skilled nursing beds, and extended care beds as of December 31.

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