

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.

**Combined Financial Statements and
Combining Supplemental Schedules
December 31, 2013 and 2012**

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.

Index

December 31, 2013 and 2012

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Independent Auditor's Report

To the Board of Trustees
Meridian Health System, Inc.

We have audited the accompanying combined financial statements of Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc. (the "Corporations", as described in Note 1), which comprise the combined balance sheets as of December 31, 2013 and 2012, and the related combined statements of operations and of changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Combined Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Corporations' preparation and fair presentation of the combined 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 Corporations' 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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of the Corporations as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matter

Our audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information presented on pages 41-42 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining information has been subjected to the auditing procedures applied in the audit of the 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 of America. In our opinion, the combining information is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole. The combining information is presented for purposes of additional analysis of the combined financial statements rather than to present the financial position, results of operations and cash flows of the individual organizations and is not a required part of the combined financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and cash flows of the individual organizations.

PricewaterhouseCoopers LLP

March 31, 2014

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Balance Sheets
December 31, 2013 and 2012

| <i>(in thousands)</i> | 2013 | 2012 |
|---|---------------------|---------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 196,898 | \$ 179,123 |
| Assets limited as to use and short-term investments | 255,365 | 260,650 |
| Patient accounts receivable, less allowance for uncollectible accounts of \$49,125 in 2013 and \$37,483 in 2012 | 128,128 | 137,278 |
| Due from affiliates, net | 4,529 | 1,237 |
| Other current assets | 38,688 | 34,885 |
| Total current assets | 623,608 | 613,173 |
| Assets limited as to use and investments, noncurrent portion | | |
| Under Board of Trustee designation and investments | 409,634 | 362,765 |
| Under bond indenture agreements | - | 4,216 |
| Total noncurrent assets limited as to use and investments | 409,634 | 366,981 |
| Property, plant and equipment, net | 782,728 | 744,019 |
| Other assets | 72,564 | 60,881 |
| Interest in net assets of foundations | 71,564 | 63,883 |
| Due from affiliates, net | 8,830 | 8,929 |
| Total assets | <u>\$ 1,968,928</u> | <u>\$ 1,857,866</u> |
| Liabilities and Net Assets | | |
| Current liabilities | | |
| Current maturities of long-term debt and capital lease obligations | \$ 19,118 | \$ 18,882 |
| Accounts payable and accrued expenses | 146,724 | 143,665 |
| Estimated amounts due to third party payors | 39,398 | 44,646 |
| Due to affiliates, net | 4,206 | 3,276 |
| Other current liabilities | 47,760 | 47,947 |
| Total current liabilities | 257,206 | 258,416 |
| Long-term debt and capital lease obligations, less current maturities | 586,947 | 611,615 |
| Accrued pension liability | 30,552 | 75,550 |
| Other liabilities | 190,806 | 209,837 |
| Total liabilities | <u>1,065,511</u> | <u>1,155,418</u> |
| Net assets | | |
| Unrestricted | 831,826 | 638,538 |
| Temporarily restricted | 50,144 | 42,844 |
| Permanently restricted | 21,447 | 21,066 |
| Total net assets | <u>903,417</u> | <u>702,448</u> |
| Total liabilities and net assets | <u>\$ 1,968,928</u> | <u>\$ 1,857,866</u> |

The accompanying notes are an integral part of these combined financial statements.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Statements of Operations
Years Ended December 31, 2013 and 2012

| <i>(in thousands)</i> | 2013 | 2012 |
|--|--------------|--------------|
| Unrestricted revenues, gains and other support | | |
| Patient service revenue, net of contractual allowances and discounts | \$ 1,412,764 | \$ 1,387,855 |
| Provision for bad debts | 76,480 | 71,538 |
| Net patient service revenue, less provision for bad debts | \$ 1,336,284 | \$ 1,316,317 |
| Other revenue | 57,447 | 42,875 |
| Net assets released from restriction used for operating activities | 2,500 | 1,595 |
| Total operating revenues | 1,396,231 | 1,360,787 |
| Expenses | | |
| Salaries, wages and contracted labor | 557,942 | 552,599 |
| Physician salaries and fees | 47,263 | 45,095 |
| Employee benefits | 143,104 | 136,153 |
| Supplies and other expenses | 488,613 | 473,047 |
| Depreciation and amortization | 62,407 | 64,418 |
| Interest | 32,563 | 35,005 |
| Provision for bad debts | 2,823 | 1,690 |
| Total operating expenses | 1,334,715 | 1,308,007 |
| Income from operations | 61,516 | 52,780 |
| Nonoperating revenues (losses) | | |
| Investment income | 25,328 | 14,377 |
| Unrealized gain (loss) on derivative instruments | 34,708 | (391) |
| Loss on extinguishment of debt | (1,356) | (2,060) |
| Other gains (losses), net | 169 | (26) |
| Excess of revenues over expenses | 120,365 | 64,680 |
| Change in net unrealized gains (losses) on investments | 22,139 | 19,611 |
| Net assets released from restriction for capital acquisition | 6,951 | 15,910 |
| Increase in unrestricted net assets before other adjustments | 149,455 | 100,201 |
| Equity transfers to affiliates | (5,969) | (2,400) |
| Other changes in pension benefits and plan assets | 49,524 | (7,453) |
| Other changes in unrestricted net assets | 278 | 181 |
| Increase in unrestricted net assets | \$ 193,288 | \$ 90,529 |

The accompanying notes are an integral part of these combined financial statements.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.

Combined Statements of Changes in Net Assets Years Ended December 31, 2013 and 2012

| <i>(in thousands)</i> | Unrestricted | Temporarily Restricted | Permanently Restricted | Total Net Assets |
|--|--------------|---------------------------|---------------------------|---------------------|
| Balances at December 31, 2011 | \$ 548,009 | \$ 42,071 | \$ 20,528 | \$ 610,608 |
| Excess of revenues over expenses | 64,680 | - | - | 64,680 |
| Change in net unrealized gains on investments | 19,611 | - | - | 19,611 |
| Increase in interest in affiliated fund raising organizations | - | 18,278 | 538 | 18,816 |
| Net assets released from restriction for capital acquisition | 15,910 | (15,910) | - | - |
| Net assets released from restriction used for operating activities | - | (1,595) | - | (1,595) |
| Equity transfers to affiliates | (2,400) | - | - | (2,400) |
| Other changes in pension benefits and plan assets | (7,453) | - | - | (7,453) |
| Other changes in net assets | 181 | - | - | 181 |
| Increase in net assets | 90,529 | 773 | 538 | 91,840 |
| Balances at December 31, 2012 | 638,538 | 42,844 | 21,066 | 702,448 |
| Excess of revenues over expenses | 120,365 | - | - | 120,365 |
| Change in net unrealized gains on investments | 22,139 | - | - | 22,139 |
| Increase in interest in affiliated fund raising organizations | - | 16,751 | 381 | 17,132 |
| Net assets released from restriction for capital acquisition | 6,951 | (6,951) | - | - |
| Net assets released from restriction used for operating activities | - | (2,500) | - | (2,500) |
| Equity transfers to affiliates | (5,969) | - | - | (5,969) |
| Other changes in pension benefits and plan assets | 49,524 | - | - | 49,524 |
| Other changes in net assets | 278 | - | - | 278 |
| Increase in net assets | 193,288 | 7,300 | 381 | 200,969 |
| Balances at December 31, 2013 | \$ 831,826 | \$ 50,144 | \$ 21,447 | \$ 903,417 |

The accompanying notes are an integral part of these combined financial statements.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Statements of Cash Flows
Years Ended December 31, 2013 and 2012

(in thousands)

| | 2013 | 2012 |
|--|-------------------|-------------------|
| Cash flows from operating activities | | |
| Change in net assets | \$ 200,969 | \$ 91,840 |
| Adjustments to reconcile change in net assets to net cash | | |
| Gain on disposal of assets | (72) | (40) |
| Provision for bad debts | 79,303 | 73,228 |
| Depreciation and amortization | 62,328 | 64,219 |
| Original issue premium on bond issue | 3,927 | - |
| Loss on extinguishment of debt | 1,356 | 2,060 |
| Amortization of original issue premium | (1,705) | (843) |
| Amortization of fair market value adjustment on long term debt | 72 | 199 |
| Change in net realized and unrealized gains on investments | (37,452) | (27,991) |
| Unrealized (gains) loss on derivative instruments | (34,708) | 391 |
| Unrealized (gains) loss on trading securities | (4,691) | 1,060 |
| Restricted contributions for capital acquisitions | (6,951) | (15,910) |
| Other changes in pension benefits and plan assets | (49,524) | 7,453 |
| Equity transfers to affiliates, net | 5,969 | 2,400 |
| Changes in assets and liabilities | | |
| Increase in net patient accounts receivable | (70,153) | (82,519) |
| Increase in other assets | (26,059) | (6,641) |
| Increase in accounts payable and accrued expenses | 3,059 | 16,090 |
| (Decrease) increase in estimated amounts due to third party payors | (4,065) | 11,950 |
| Increase in other liabilities | 13,093 | 3,546 |
| Net cash provided by operating activities | <u>134,696</u> | <u>140,492</u> |
| Cash flows from investing activities | | |
| Purchases of property, plant and equipment | (94,243) | (67,488) |
| Proceeds from sale of property and equipment | 73 | 48 |
| Changes in assets limited as to use and investments | <u>4,775</u> | <u>(38,876)</u> |
| Net cash used in investing activities | <u>(89,395)</u> | <u>(106,316)</u> |
| Cash flows from financing activities | | |
| Principal payments on long-term debt and capital lease obligations | (19,532) | (21,340) |
| Early extinguishment of debt | (38,075) | (135,400) |
| Proceeds from borrowings | 29,525 | 135,415 |
| Restricted contributions for capital acquisitions | 6,951 | 15,910 |
| Financing costs | (426) | (229) |
| Equity transfers to affiliates, net | <u>(5,969)</u> | <u>(2,400)</u> |
| Net cash used in financing activities | <u>(27,526)</u> | <u>(8,044)</u> |
| Increase (decrease) in cash and cash equivalents | 17,775 | 26,132 |
| Cash and cash equivalents | | |
| Beginning of year | <u>179,123</u> | <u>152,991</u> |
| End of year | <u>\$ 196,898</u> | <u>\$ 179,123</u> |
| Supplemental information | | |
| Cash paid for interest | \$ 33,257 | \$ 31,114 |
| Construction and retainage payable | 6,390 | 4,818 |

The accompanying notes are an integral part of these combined financial statements.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.

Combined Notes to Financial Statements

Years Ended December 31, 2013 and 2012

(in thousands)

1. Organization

Meridian Health System, Inc. ("MH"), a not-for-profit corporation, is the parent organization and sole member of Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc. MH is also the parent corporation or has equity interest in various other New Jersey health care organizations which provide a comprehensive range of services including home care, ambulatory care, ambulance services and other health related services.

Meridian Hospitals Corporation ("MHC") and Meridian Nursing and Rehabilitation Inc. ("MNR") are defined as the "Obligated Group" under the terms of the Master Trust indenture related to the various New Jersey Health Care Facilities Financing Authority ("NJHCFFA") revenue bond issues. The combined financial statements, which include only the accounts of Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc., do not include all of the controlled affiliate organizations of Meridian Health System, Inc. These financial statements are prepared to satisfy certain reporting requirements as described in the Master Trust Indenture.

MHC is a not-for-profit corporation that operates an acute care hospital system which provides primary and tertiary care services to the residents of the Monmouth and Ocean County regions of New Jersey. MHC was established for the promotion of health and to serve the public rather than private interest. To further this purpose, MHC also provides various programs for medical training, research, education and conducts activities established to improve the health of the community.

MHC was formed on January 1, 1997 and currently operates five hospital divisions. Jersey Shore University Medical Center ("JSUMC") operates a major teaching, acute care hospital, the K. Hovnanian Children's Hospital and regional trauma center located in Neptune, New Jersey. Ocean Medical Center ("OMC") operates an acute care hospital located in Brick, New Jersey and the OMC Care Center, a satellite emergency department in Point Pleasant, New Jersey. Riverview Medical Center ("RMC") operates an acute care hospital and a comprehensive rehabilitation unit located in Red Bank, New Jersey. Southern Ocean Medical Center ("SOMC") operates an acute care hospital located in Manahawkin, New Jersey. Bayshore Community Hospital ("BCH") operates an acute care hospital located in Holmdel, New Jersey. BCH became a subsidiary of MHC as parent organization and sole member as a result of the change in BCH's corporate member in September 2010.

MNR currently operates three full service long-term care facilities located in Brick, Ocean Grove and Shrewsbury, New Jersey and a sub-acute rehabilitation facility in Wall, New Jersey. In September 2010, Bayshore Health Care Center ("BHCC") became a subsidiary of MNR as parent organization and sole member as a result of the change in BHCC's corporate member. BHCC provides residential, medical, and health services to elderly persons by operating a long-term care facility of 231 beds, which includes a 60-bed subacute unit, and 11-bed ventilator unit facility for chronic patients. Additionally, they operate a 74-unit assisted living facility known as the Willows at Holmdel, that provides housing for elderly residents.

Effective April 1, 2013, MH completed the full asset merger of BCH into MHC as a fifth division and BHCC into MNR. BCH and BHCC ceased to exist as separate legal entities.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.

Combined Notes to Financial Statements

Years Ended December 31, 2013 and 2012

(in thousands)

2. Summary of Significant Accounting Policies

The following is a summary of the Obligated Group's (the "Corporation") significant accounting policies:

Basis of Presentation

The combined financial statements included only the accounts of the Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc., as of December 31, 2013 and Meridian Hospitals Corporation and Subsidiary and Meridian Nursing and Rehabilitation Inc. and Subsidiary as of December 31, 2012 and for the year then ended. As detailed above, effective April 1, 2013, Meridian Health completed the full asset merger of BCH into Meridian Hospitals Corporation and BHCC into Meridian Nursing and Rehabilitation Inc. All significant inter-affiliate accounts and transactions have been eliminated in combination.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates include the collectability of accounts receivable, third-party settlement accounts, useful lives for depreciation of fixed assets, long-term assets impairment, investment valuation, insurance, pension and other employee benefit cost, among others. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period that they are determined to be necessary. Actual results may differ from those estimates.

Income Taxes

The Corporations are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code ("Code") and are exempt from federal income taxes on related income. The Corporations are also exempt from state income taxes. Per the requirement to assess for tax uncertainty, management has determined that it does not have any significant uncertain tax positions required to be accrued or reported.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly-liquid instruments with original maturity of three months or less. Cash and cash equivalents exclude assets limited as to use by board designation or under trust agreements.

At December 31, 2013 and 2012 the cash and cash equivalents in major financial institutions exceeded the Federal Depository Insurance limits. Management believes the credit risk related to these deposits is minimal.

Assets Limited as to Use and Investments

Assets limited as to use principally consist of cash and investments held by trustees under the various indenture agreements and funds set aside by the Board of Trustees over which the Board retains control and may, at its discretion, subsequently use for other purposes. Assets limited as to use and investments are recorded at fair value as described below.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.

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(in thousands)

Investment income on investments held under bond indenture agreements is included in other operating revenue. Investment income or losses on all other investments, including realized gains and losses on investments, interest, dividends, changes in values on trading securities, and related investment management fees are included in nonoperating revenues (losses). Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities.

Fair Value Measurements

Fair Value Accounting establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or liability. Fair value requires an organization to determine the unit of account, the mechanism of hypothetical transfer and the appropriate markets for the asset or liability being measured.

The guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entities own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. As a basis for comparing assumptions, accounting guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair values as follows:

- Level 1 Financial instruments for which quoted market prices are available in active markets. Level 1 assets consist of Money Market Funds, Equity Securities, some Mutual Funds, and U.S. Treasury Notes/Bills securities as they are traded in an active market with sufficient volume and frequency of transactions.
- Level 2 Financial instruments for which there are inputs, other than the quoted prices in active markets, that are observable either directly or indirectly. Level 2 assets consist of certain Money Market Funds, Government Backed Securities, Corporate Bonds, and Mutual Funds. These investments can also be valued by the investment portfolio managers utilizing a portfolio system, which relies on one of the largest pricing services and is used by many mutual funds. If the pricing service does not have a price, the Bloomberg submitted price is used. The Corporations review the results of these valuations in assessing the fair value of investments.
- Level 3 Financial instruments for which there are unobservable inputs, in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are as follows:

- Market Approach – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;

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(in thousands)

- Cost Approach – Amount that would be required to replace the service capacity of an asset (i.e. replacement cost); and
- Income Approach – Techniques to convert future amounts to single present amount based on market expectations (including present value techniques, option-pricing models, and lattice models).

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Inputs are used in applying the various valuation techniques and broadly refer to the assumptions the market participants use to make valuation decisions. Inputs may include price information, credit data, liquidity statistics and other factors.

The following is a description of methods and assumptions used to estimate fair value. There have been no changes in valuation methods and assumptions used at December 31, 2013 and 2012.

- Corporate Equity Securities – Securities listed on national stock exchanges are valued at the last published sales price on the last business day of the year; over-the-counter securities for which no sale was reported on the last business day of the year are valued at the latest reported bid price from a published source.
- Mutual Funds and Money Market Funds – Fair value estimates for mutual funds are based on net asset value (NAVs) calculated by the funds' independent administrators which are calculated daily. Redemptions from each of the funds can be made daily on the latest reported NAV.
- U.S. Government Debt and Corporate Debt Securities – Valued on the basis of the quoted market prices at year-end. If quoted market prices are not available for the investments, these investments are valued based on yields currently available on comparable securities or issuers with similar credit ratings.
- Common/Collective Trust – Valued based on a net unit value. The net unit value of the trust is derived from the value of the underlying securities as determined by the trust at year-end. The investments of the common/collective trust consist primarily of securities with quoted market prices.
- Interest-Bearing Cash Equivalents – Consist primarily of U.S. Government debt securities with maturities less than three months from year-end. These investments are valued on the basis of the quoted market prices at year-end. If quoted market prices are not available for the investments, these investments are valued based on yields currently available on comparable securities or issuers with similar credit ratings.
- Derivative Instruments – Consist of interest rate swap agreements. Value is determined using a market-based interest rate yield curve adjusted specifically to take into account the Corporations' risk of nonperformance.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
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Years Ended December 31, 2013 and 2012

(in thousands)

The Corporations have elected to record the alternative investments at cost. Alternative investments include a Real Estate fund, a Private Equity fund and a Commodities fund. The defined cash balance plan records these investments at fair value as follows:

- Real Estate Fund – Value is derived by applying ownership percentage to the value of the fund as determined by the fund's management at year-end. The investments of the real estate fund consist primarily of securities with quoted market prices.
- Private Equity Fund – Value for investments is derived by applying ownership percentage to the value of the fund as determined by the fund's management at year-end. The investments of the private equity fund consist primarily of investments in limited partnerships. These investments are fair valued at their net asset value as reported by their underlying investment manager. In the event that the partnership is unable to obtain the value of any portfolio investment from the applicable investment manager, the fair value of such portfolio investment shall be determined by the general partner.
- Commodities Fund – Valued on year-end net asset values of the respective classes of shares, which are determined monthly, or at the date of any subscription to or redemption from the fund. The net asset value is equal to the excess value of the Fund's assets over the sum of its liabilities. Substantially all of the assets of the Fund are invested in shares of a Master Fund. The value of the Fund's assets and liabilities are determined in accordance with accounting principles acceptable in the United States. Futures and forward contracts are valued based upon the settlement price on the exchanges where they are traded, and where there is no settlement price, value will be based upon the last trade price. If the Fund invests in a commingled entity, the value of the Fund's investment will be the value provided by the manager of the entity, unless the investment manager determines such value is not reasonable, in which case the investment manager shall determine the value of the investment.

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

The agreements underlying participation in some of these investments may limit the Corporations' ability to liquidate its interests in such investments for a period of time. While the Corporations have not been informed of any redemption restrictions, some of the more significant restrictions contained in the Board Designated investments and the Pension Plan investments are:

- The TAP Fund generally permits a shareholder to redeem all or any portion of its shares upon five business days. However, distributions may be limited in amount or temporarily suspended in circumstances described in the fund agreement. Shares not redeemed from the fund remain at risk to fund performance until the effective date of the redemption.
- Members may generally withdraw any portion or all of their capital account from the REEF Real Estate Securities Commingled Fund at the end of any month after providing ten business days prior written notice.

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(in thousands)

- The Corporations may not redeem any interest in the Portfolio Advisors Private Equity Fund V without the consent of the general partner. As a result, at December 31, 2013 and 2012, the Corporations have Board Designated investments of \$4,362 and \$4,730, respectively, which are restricted from redemption under this lock-up provision. At December 31, 2013 and 2012, the Corporations have in the Pension Plan investments of \$6,835 and \$6,491, respectively, which are restricted from redemption under this lock-up provision.

Impairment of Investments

Investments are reviewed for impairment whenever events or change in circumstances indicate that the fair value of investments below cost will be considered other than temporary. There were no such losses reported for the years ended December 31, 2013 and 2012.

Inventories

Inventories, primarily supplies, are included in other current assets and are stated at the lower of cost or market.

Other Assets

Included in other assets are various investments in health-related ventures. Investments are accounted for on the cost or equity method depending upon the ownership interest and the degree of control exercised.

Financial Instruments

The Corporations have entered into interest rate swap agreements to manage its exposure to fluctuations in interest rates (interest rate risk) and lower cost of capital. These swap agreements involve the exchange of fixed and variable rate interest payments between the Corporations and counterparties based on common notional principal amounts and maturity dates that correspond to the Corporations' outstanding long-term debt.

The Corporations recognize all derivatives (interest rate swap agreements) as liabilities in the combined statement of financial position and measures these instruments at fair value. Changes in fair value of these instruments are reported in the financial statements as discussed in Note 8.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. The Corporations determine depreciation using the straight-line method, over the estimated useful life of each class of depreciable asset. Estimated lives range from 3 to 15 years for equipment and up to 40 years for buildings.

Capitalized leases are recorded at their present value at the inception of the lease. Equipment under capital leases is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the combined financial statements. Gains and losses resulting from the retirement of property, plant and equipment are included in the results of current operations.

Gifts of long-lived assets such as property, plant and equipment are determined at the fair value at the date of the gift and reported as an increase to unrestricted net assets unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Notes to Financial Statements
Years Ended December 31, 2013 and 2012

(in thousands)

be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or change in circumstances indicate that the carrying amount may not be recoverable. If the sum for the expected future undiscounted cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and carrying value of the asset. There were no impairment losses recorded for the years ended December 31, 2013 and 2012.

Deferred Financing Costs

Deferred financing costs represent costs incurred to obtain various capital financings. Deferred financing costs are amortized using the effective interest method or the straight-line method when not materially different over the term of the related debt. Deferred financing costs totaled \$5,064 and \$5,042, net of accumulated amortization of \$1,855 and \$1,172 at December 31, 2013 and 2012, respectively. These amounts are reported within other assets in the accompanying combined balance sheets.

Professional Liability Insurance

The Corporations' policy is to accrue an estimate of the ultimate cost of malpractice and workers compensation claims under insurance policies. This accrued liability is included in other liabilities. The Corporations also record an estimate for insurance recoveries associated with these claims. This amount is included in other assets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those funds whose use has been limited by donors to a specified time period and/or purpose. Temporarily restricted net assets are available for the funding of healthcare services and capital acquisitions. Permanently restricted net assets have been restricted by donors to be held in perpetuity and the income from permanently restricted net assets is expendable to support various health care services. Resources arising from the results of operations or assets set aside by the Board of Trustees are not considered to be donor restricted.

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as the cost basis. The gifts 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 expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the combined statement of operations as net assets released from restrictions. The Corporations' policy is to exclude from operating income, net assets released from restrictions for capital acquisitions. Net assets released from restrictions for noncapital purposes are included within operating income. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying financial statements.

The Corporations adopted the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). This law governs management and spending of donor-restricted endowment funds and

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permanently restricted gifts. Disclosure requirements under this act have been adopted by the Corporations.

The Boards of Jersey Shore University Medical Center Foundation, Ocean Medical Center Foundation, Riverview Medical Center Foundation, Southern Ocean Medical Center Foundation, Bayshore Community Hospital Foundation and Meridian Health Foundation ("Meridian Foundations"), consistent with regulatory requirements, require the preservation of the fair value of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result, Meridian Foundations classify permanently restricted net assets as (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in accordance with donor intent and in a manner consistent with the standard of prudence prescribed by state laws.

Meridian Foundations have a practice of appropriating for distribution each year the first 5% of the current earnings on endowment funds. In establishing this practice, Meridian Foundations considered the duration and preservation of the funds; the purposes of both the fund and the Corporation; the general economic conditions including the effects of inflation or deflation; the investment policy and expected total income return and appreciation on the investments; and other resources of the Corporations. Accordingly, over the long term, Meridian Foundations expect the current spending practice to allow its endowments to grow at an anticipated rate of 3% annually.

To satisfy its long-term rate-of-return objectives, Meridian Foundations rely on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Meridian Foundations target a diversified asset allocation of 50% equity-based investments, 40% fixed Income and 10% alternative investments in accordance with the investment policy.

Included in unrestricted net assets are board designated endowment funds of \$24,223 and \$22,959 at December 31, 2013 and 2012, respectively.

Performance Indicator

The combined statements of operations include excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include changes in net unrealized gains and losses on investments not classified as trading securities, permanent transfers of assets to and from affiliates for other than goods and services, pension liability adjustments, and contributions of long-lived assets.

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The Corporations differentiate operating activities through the use of income from operations as an intermediate measure of operations. For the purposes of display, certain investment income and other transactions, which management does not consider being components of the Corporations' operating activities, are excluded from the income from operations and reported as nonoperating revenues (losses) in the combined statement of operations.

Net Patient Service Revenue

Net patient service revenue is accounted for on the accrual basis in the period in which the service is provided. These amounts are net of appropriate allowances to give recognition to differences between the Corporations' charges and reimbursement rates from third party payors. The Corporations are reimbursed from third party payors under various methodologies based on the level of care provided. Certain net revenues received are subject to audit and retroactive adjustment for which amounts are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

A summary of the payment arrangements with major third party payers is as follows:

- Medicare - inpatient acute care services and most outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Certain outpatient services and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology, the Corporations are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Corporations. Annual net patient service revenue is approximately \$420,000 in 2013 and 2012. The Medicare cost reports have been audited and finalized by the Medicare fiscal intermediary for MHC through December 31, 2007 with the exception of 2005 which has not been finalized by the fiscal intermediary.
- Medicaid - inpatient acute care services rendered to Medicaid program beneficiaries are reimbursed under a prospective methodology which is based on the former Chapter 83 reimbursement system. Outpatient services are paid based upon a cost reimbursement methodology and certain services are paid based on a Medicaid fee schedule. Annual net patient service revenue is approximately \$20,000 in 2013 and 2012. The Medicaid cost reports have been audited and finalized by the Medicaid fiscal intermediary for JSUMC, OMC, and BCH through December 31, 2009 and for RMC and SOMC through December 31, 2010.
- The Corporations have also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per patient day or procedure and discounts from established charges. Annual net patient service revenue from these payors is approximately \$500,000 in 2013 and 2012.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation for which action for noncompliance includes fines, penalties and exclusion from the Medicare and Medicaid programs. The Corporations believe that they are currently in compliance

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with all applicable laws and regulations. The Corporations have established a Corporate Compliance Program to monitor compliance with various regulations.

Functional Expenses

The Corporations provide general health care services and programs. Expenses related to providing these services consist of the following:

| | December 31, | |
|----------------------------|---------------------|---------------------|
| | 2013 | 2012 |
| Health care services | \$ 1,094,883 | \$ 1,062,126 |
| General and administrative | 239,832 | 245,881 |
| | <u>\$ 1,334,715</u> | <u>\$ 1,308,007</u> |

3. Charity Care

The Corporations provide care to patients who meet certain criteria defined by the New Jersey Department of Health and Senior Services without charge or at amounts less than its established rates. The Corporations maintain records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished. The Corporations receive partial reimbursement for the uncompensated care provided (Note 4). Of the Corporation's total combined operating expenses reported for 2013 and 2012, estimated costs of \$65,312 and \$59,433 for 2013 and 2012, respectively, are attributable to providing services to charity patients. The estimated costs of providing charity care services are based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Corporations' total operating expenses, excluding bad debt expense, divided by gross patient service revenue.

4. Patient Service Revenue and Related Adjustments

The Corporations record gross patient service revenue on an accrual basis at established rates, with contractual and other allowances added to or deducted from such amounts to determine net patient service revenue. The Corporations maintain policies and records to identify and monitor these contractual allowances and the level of charity care. These records include the amount of deductions from gross revenue due to qualified services provided under the State's charity care guidelines. In 2013 and 2012, the Corporations recorded \$12,803 and \$17,567, respectively, in net patient service revenue related to changes in estimates to amounts due to third party payors.

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The components of net patient service revenue are as follows:

| | December 31, | |
|--|---------------------|---------------------|
| | 2013 | 2012 |
| Gross charges | \$ 6,877,782 | \$ 6,438,510 |
| Contractual and other allowances | (5,491,737) | (5,082,302) |
| Provision for bad debts | (76,480) | (71,538) |
| Change in estimate of prior years' net patient service revenue | 12,803 | 17,567 |
| Charity care subsidy | 9,542 | 9,690 |
| Hospital relief subsidy | 4,374 | 4,390 |
| | <u>\$ 1,336,284</u> | <u>\$ 1,316,317</u> |

Collectibility of Accounts Receivables

The process for estimating the ultimate collection of receivables involves significant assumptions and judgments. The Corporations have implemented a monthly standardized approach to estimate and review the collectibility of receivables based on the payor classification and the period from which the receivables have been outstanding. Account balances are written off against the allowance when management feels it is probable the receivable will not be recovered. Historical collection and payor reimbursement experience is an integral part of the estimation process related to reserves for doubtful accounts. In addition, the Corporations assess the current state of billing functions in order to identify any known collection or reimbursement issues and assess the impact, if any, on reserve estimates. The Corporations believe that the collectibility of receivables is directly linked to the quality of its billing processes, most notably those related to obtaining the correct information in order to bill effectively for the services provided. Revisions in reserve for doubtful accounts estimates are recorded as an adjustment to bad debt expense.

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5. Assets Limited as to Use and Investments

The following table provides a summary of the Corporations' assets limited as to use and investments that are measured at fair value on a recurring basis:

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Balances at December 31, 2013 |
|---|---|---|-------------------------------------|
| Under bond indenture agreements held by Trustee | | | |
| Cash and cash equivalents | \$ 12,216 | \$ - | \$ 12,216 |
| Total under bond indenture agreements held by trustee | \$ 12,216 | \$ - | 12,216 |
| Under Board of Trustees designation and investments held as available for sale | | | |
| Cash and cash equivalents | \$ 12,071 | \$ 3,136 | 15,207 |
| Mutual funds - equity | 19,364 | 225,129 | 244,493 |
| Corporate debt securities | - | 5,515 | 5,515 |
| Municipal debt securities | - | 6,097 | 6,097 |
| U.S. government obligations | 157,662 | 66,564 | 224,226 |
| | \$ 189,097 | \$ 306,441 | 495,538 |
| Alternative investments | | | 16,422 |
| Certificates of deposits | | | 15,815 |
| Accrued interest | | | 461 |
| Total under Board of Trustee designation and investments held for available for sale | | | 528,236 |
| Under Board of Trustees designation and investments held as trading securities | | | |
| Cash and cash equivalents | \$ 8,221 | \$ 6,122 | 14,343 |
| U.S. government obligations | 8,086 | 9,624 | 17,710 |
| Corporate debt securities | - | 62,943 | 62,943 |
| Corporate equity securities | 26,203 | 2,641 | 28,844 |
| | \$ 42,510 | \$ 81,330 | 123,840 |
| Accrued interest | | | \$ 327 |
| Total under Board of Trustee designation and investments held as trading securities | | | 124,167 |
| Restricted cash | | | 380 |
| Total assets limited as to use | | | 664,999 |
| Less: Current portion | | | 255,365 |
| Assets limited as to use and investments noncurrent portion | | | \$ 409,634 |

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| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Balances at December 31, 2012 |
|---|---|---|-------------------------------------|
| Under bond indenture agreements held by Trustee | | | |
| Cash and cash equivalents | \$ 16,275 | \$ - | \$ 16,275 |
| Total under bond indenture agreements held by trustee | \$ 16,275 | \$ - | 16,275 |
| Under Board of Trustees designation and investments held as available for sale | | | |
| Cash and cash equivalents | \$ 8,929 | \$ 2 | 8,931 |
| Mutual funds - equity | 16,503 | 191,501 | 208,004 |
| Corporate debt securities | - | 4,927 | 4,927 |
| Municipal debt securities | - | 6,383 | 6,383 |
| U.S. government obligations | 168,636 | 67,823 | 236,459 |
| | \$ 194,068 | \$ 270,636 | 464,704 |
| Alternative investments | | | 14,944 |
| Certificates of deposits | | | 15,380 |
| Accrued interest | | | 793 |
| Total under Board of Trustee designation and investments held for available for sale | | | 495,821 |
| Under Board of Trustees designation and investments held as trading securities | | | |
| Cash and cash equivalents | \$ - | \$ 2,737 | 2,737 |
| Mutual funds - equity | 7,176 | - | 7,176 |
| U.S. government obligations | 5,255 | 12,377 | 17,632 |
| Corporate debt securities | - | 59,246 | 59,246 |
| Corporate equity securities | 25,626 | 2,409 | 28,035 |
| | \$ 38,057 | \$ 76,769 | 114,826 |
| Accrued interest | | | \$ 290 |
| Total under Board of Trustee designation and investments held as trading securities | | | 115,116 |
| Restricted cash | | | 419 |
| Total assets limited as to use | | | 627,631 |
| Less: Current portion | | | 260,650 |
| Assets limited as to use and investments noncurrent portion | | | \$ 366,981 |

There were no investments in 2013 or 2012 with unobservable inputs that cannot be corroborated by observable market data and therefore, classified as Level 3.

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There were no transfers between Levels 1 and 2 during 2013 and 2012.

At December 31, 2013, MHC's remaining outstanding funding commitments to alternative investments approximated \$2,192.

Assets under bond indenture agreements held by trustees are maintained in the following accounts:

| | December 31, | |
|--|---------------------|------------------|
| | 2013 | 2012 |
| Debt service fund, principal | \$ 7,350 | \$ 6,994 |
| Debt service fund, interest | 4,816 | 5,331 |
| Debt service reserve fund | - | 3,939 |
| Cost of issuance fund | 50 | 11 |
| Total assets under bond indenture agreements | <u>\$ 12,216</u> | <u>\$ 16,275</u> |

Included in other operating revenue at December 31, 2013 and 2012 is \$4 of interest income on assets under bond indenture agreements.

Investment income consists of the following:

| | December 31, | |
|---|---------------------|------------------|
| | 2013 | 2012 |
| Interest income | \$ 6,476 | \$ 7,679 |
| Realized gains and losses | 15,557 | 8,380 |
| Net change in unrealized gains and losses | 4,691 | (1,060) |
| Investment management fees | (1,448) | (1,255) |
| Other gains and losses | 52 | 633 |
| | <u>\$ 25,328</u> | <u>\$ 14,377</u> |

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6. Property, Plant and Equipment

Property, plant and equipment, including assets held under capital lease obligations consist of the following:

| | December 31, | |
|---|---------------------|-------------------|
| | 2013 | 2012 |
| Land | \$ 25,063 | \$ 25,062 |
| Land improvements | 12,525 | 12,378 |
| Buildings and fixed equipment | 1,014,950 | 984,772 |
| Major movable equipment | 492,457 | 469,641 |
| Construction-in-progress | 101,159 | 55,431 |
| | <u>1,646,154</u> | <u>1,547,284</u> |
| Accumulated depreciation and amortization | <u>(863,426)</u> | <u>(803,265)</u> |
| Property, plant and equipment, net | <u>\$ 782,728</u> | <u>\$ 744,019</u> |

Amortization of assets held under capital lease obligations and total depreciation expense was \$61,923 in 2013 and \$63,848 in 2012.

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7. Long-Term Debt and Capital Lease Obligations

Long term debt and capital lease obligations consist of the following:

| | December 31, | |
|--|---------------------|-------------|
| | 2013 | 2012 |
| \$29,525 New Jersey Health Care Facilities Financing Authority ("NJHCFFA") Meridian Health System Obligated Group Issue, Series 2013A Refunding Bonds, in varying maturities through July 1, 2032 at annual interest rates varying between 2.0% and 5.0%. Interest is payable each January 1 and July 1 and principal is payable each July 1 beginning in 2013. The bonds collateralized by a lien and a security interest on the gross receipts of the Obligated Group. | \$ 27,445 | \$ - |
| \$40,005 NJHCFFA Meridian Health System Obligated Group Issue, Series 2012A maturing on July 1, 2033. The interest on the bonds is payable monthly based upon market rates. Principal is payable payable each July 1 beginning in 2013. The bonds were directly placed. As of December 31, 2013, the interest rate on the bonds was 0.68%. | 39,505 | 40,005 |
| \$47,705 NJHCFFA Meridian Health System Obligated Group Issue, Series 2012B maturing on July 1, 2038. The interest on the bonds is payable monthly based upon market rates. Principal is payable payable each July 1 beginning in 2013. The bonds were directly placed. As of December 31, 2013, the interest rate on the bonds was 0.80%. | 47,155 | 47,705 |
| \$47,705 NJHCFFA Meridian Health System Obligated Group Issue, Series 2012C maturing on July 1, 2038. The interest on the bonds is payable monthly based upon market rates. Principal is payable payable each July 1 beginning in 2013. The bonds were directly placed. As of December 31, 2013, the interest rate on the bonds was 0.82%. | 47,155 | 47,705 |
| \$200,595 NJHCFFA Meridian Health System Obligated Group Issue, Series 2011 Refunding Bonds, in varying maturities through July 1, 2027 at annual interest rates varying between 2.0% and 5.0%. Interest is payable each January 1 and July 1 and principal is payable each July 1 beginning in 2012. The bonds are collateralized by a lien and a security interest on the gross receipts of the Obligated Group. | 175,900 | 186,735 |
| \$145,125 NJHCFFA Meridian Health System Obligated Group Issue, Series 2007 Revenue Bonds, maturing on July 1, 2038 at an annual interest rate of 5.0%. Interest is payable each January 1 and July 1 and principal is payable each July 1 beginning in 2010. The Series 2007 bonds are insured by Assured Guaranty. The bonds are collateralized by a pledge on all forms of gross receipts. | 140,950 | 142,675 |
| \$18,390 NJHCFFA Southern Ocean County Hospital issue, Series 2006 Revenue Bonds, maturing on July 1, 2036. The interest on the bonds is payable monthly and interest rate is determined weekly based upon market rates with a 12% per annum maximum. The principal payments are due each July 1. The bonds are backed by a letter of credit expiring in April 2016. As of December 31, 2013, the interest rate on the bonds was 0.04%. | 16,425 | 16,745 |

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| | <u>December 31,</u> | |
|---|---------------------|-------------|
| | <u>2013</u> | <u>2012</u> |
| \$5,100 NJHCFFA variable rate composite revenue bonds Series 2006 A-3 maturing on July 1, 2031. The interest on the bonds is payable monthly and the interest rate is determined weekly based on market rates with a 12% per annum maximum. The bonds are collateralized by a letter of credit expiring in November 2014. As of December 31, 2013, the interest rate on the bonds was 0.05%. | \$ 3,940 | \$ 4,160 |
| \$7,000 NJHCFFA Capital Asset Loan on behalf of Meridian Nursing and Rehabilitation at Ocean Grove, Inc. maturing on November 1, 2017. Interest is payable each June 1 and December 1 and is determined weekly. Principal is payable each December 1. The loan is collateralized by a pledge of gross revenues and a negative pledge on the real property of the Obligated Group under the Master Indenture, including but not limited to the real property comprising of the Manor by the Sea. As of December 31, 2013, the interest rate on the bonds was 1.03% | 5,050 | 5,512 |
| \$8,000 NJHCFFA variable rate composite revenue bonds Series 2004 A-1, maturing July 1, 2014. The interest on the bonds is payable monthly and the interest rate is determined weekly based on market rates with a 12% per annum maximum. The bonds are collateralized by a letter of credit expiring in July 2014. As of December 31, 2013, the interest rate on the bonds was 0.11%. | 910 | 1,790 |
| \$14,725 NJHCFFA variable rate composite revenue bonds Series 2004 A-3 maturing on July 1, 2035. The interest on the bonds is payable monthly and the interest rate is determined weekly based on market rates with a 12% per annum maximum. The bonds are collateralized by a letter of credit expiring in July 2016. As of December 31, 2013, the interest rate on the bonds was 0.06%. | 11,955 | 12,340 |
| \$60,000 NJHCFFA Meridian Health System Obligated Group Issue, Series 2003 Revenue Bonds, maturing on July 1, 2033. The interest on the bonds is payable monthly and the interest rate is determined weekly based on market rates with a 12% per annum maximum. The bonds are collateralized by a letter of credit expiring in November 2016. As of December 31, 2013, the interest rate on the bonds was 0.04%. | 60,000 | 60,000 |
| \$50,885 NJHCFFA Bayshore Community Hospital Issue, Series 2002 Revenue Bonds, in varying maturities through July 2032 at annual interest rates varying between 3.0% and 5.125%. Interest is payable each January 1 and July 1 and principal is payable each July 1. The Series 2002 revenue bonds were insured by Radian Asset Assurance Inc. The bonds were collateralized by a security interest and a lien on all BCH's gross receipts and substantially all property, plant and equipment | - | 38,075 |

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| | <u>December 31,</u> | |
|---|---------------------|-------------------|
| | <u>2013</u> | <u>2012</u> |
| \$17,255 New Jersey Economic Development Authority ("NJEDA") Series 1998A Variable Rate Demand Senior Care Revenue Bonds in varying maturities through July 2028. Interest is payable monthly and is determined on a variable interest rate. Principal is payable each July 1. The bonds are secured by a security interest in BHCC's gross receipts, a first mortgage lien on BHCC's property, plant and equipment and a letter of credit, expiring November 2014. As of December 31, 2013 the interest rate on the bonds was 0.06%. | 11,010 | 11,550 |
| Commercial mortgage with a variable interest rate equal to the LIBOR rate for each period plus 1.0%. Principal and interest are paid monthly. Interest rate at December 31, 2013 was 1.17%. | 507 | 797 |
| Capital lease obligation with an interest rate of 7.2%. This lease is collateralized by equipment financed through the lease. | <u>1,935</u> | <u>2,130</u> |
| Total long-term debt and capital lease obligations | 589,842 | 617,924 |
| Original issue premium (discount) | 16,223 | 14,001 |
| Fair market value adjustment | - | (1,428) |
| Current portion | <u>(19,118)</u> | <u>(18,882)</u> |
| Long-term debt and capital lease obligations, net of current portion | <u>\$ 586,947</u> | <u>\$ 611,615</u> |

MHC and MNR are defined as the "Obligated Group" under the terms of the Master Trust Indenture related to the NJHCFFA Revenue Bonds. The agreements contain provisions whereby certain financial ratios are to be maintained by the Obligated Group and permit additional borrowings subject to the maintenance of specific financial ratios. At December 31, 2013 and 2012, the Obligated Group was in compliance with these financial ratio requirements. Effective March 18, 2013, BCH and BHCC was included in the Obligated Group.

In October 2012, the Obligated Group completed a series of direct placement transactions in which it refinanced \$135,415 of bonds related to the Series 2003B, Series 2007 Tranche III, and Series 2007 Tranche IV issue. The Series 2003B bonds were replaced with a new Series 2012A issue. The Series 2007 Tranche III bonds were replaced with a new Series 2012B issue. The Series 2007 Tranche IV bonds were replaced with a new Series 2012C issue. The Obligated Group incurred a loss on the extinguishment of \$2,060 associated with this transaction.

In May 2013, the Corporation refinanced \$38,075 of bonds related to the BCH Series 2002. The BCH Series 2002 bonds were replaced with a new Series 2013A issue. The Corporation incurred a loss on the extinguishment of \$1,356 associated with this transaction.

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The future principal payments on long-term debt and payments on capital lease obligations are as follows:

| | Long-Term Debt | Capital Lease Obligations | Total |
|--|-------------------|---------------------------------|-------------------|
| 2014 | \$ 18,895 | \$ 350 | \$ 19,245 |
| 2015 | 18,500 | 350 | 18,850 |
| 2016 | 116,970 | 350 | 117,320 |
| 2017 | 17,193 | 350 | 17,543 |
| 2018 | 17,725 | 350 | 18,075 |
| Thereafter | 398,623 | 698 | 399,321 |
| | <u>587,906</u> | <u>2,448</u> | <u>590,354</u> |
| Amounts representing interest on capital lease obligations | - | (512) | (512) |
| Original issue discount | 16,223 | - | 16,223 |
| Current portion | <u>(18,895)</u> | <u>(223)</u> | <u>(19,118)</u> |
| Long-term portion | <u>\$ 585,234</u> | <u>\$ 1,713</u> | <u>\$ 586,947</u> |

The Corporations estimate the fair value of its NJHCFFA revenue bonds and NJEDA revenue bonds through quoted market prices after taking into account its related risk of nonperformance as determined by a third party valuation specialist. At December 31, 2013, the carrying amount and the fair value of the Corporation's NJHCFFA revenue bonds and NJEDA revenue bonds were approximately \$582,350 and \$595,290, respectively. At December 31, 2012, the carrying amount and the fair value of the Corporation's NJHCFFA revenue bonds and NJEDA revenue bonds were approximately \$608,057 and \$645,365, respectively. The Corporation classified its debt as Level 2 under the fair value measurements.

8. Interest Rate Swap Agreements

The Corporations currently have five forward starting pay fixed interest swap agreements which were entered into to mitigate variable rate exposure and take advantage of low interest rates. Under the terms of these agreements, the Corporations are paying fixed interest rates ranging from 3.329% to 3.88% in exchange for variable rate payments equal to either 67% or 68% of the one month LIBOR rate. The notional amount on these swap agreements are also tied to the outstanding principal on the underlying bond series.

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The following table sets forth the fair values of the interest rate swap agreements at December 31, 2013 and 2012:

| Fair Values of Derivative Instruments Derivatives Reported as Liabilities | | | | |
|--|-------------------|-----------|-----------------------|------------|
| 2013 | | | 2012 | |
| Balance Sheet Caption | Fair Value | | Balance Sheet Caption | Fair Value |
| Interest rate swaps not designated as hedging instruments | Other Liabilities | \$ 50,233 | Other Liabilities | \$ 85,219 |

The fair values of the Corporations' swap instruments at December 31, 2013 and 2012 are classified as a Level 2 financial instruments and reflect a risk of nonperformance adjustment of \$2,000 and \$10,000, respectively.

The following table sets forth the effect of interest rate swap agreements on the combined statements of operations for the years ended December 31, 2013 and 2012:

| Classification of Derivative Gain (Loss) Statement of Operations | Amount of Gain (Loss) Recognized in the Performance Indicator (Ineffective Portion) | |
|--|---|----------|
| | 2013 | 2012 |
| | | |
| Derivatives in nonhedging relationships | | |
| Interest rate swaps | | |
| Nonoperating revenues-unrealized gain (loss) on derivative instruments | \$ 34,708 | \$ (391) |

9. Operating Leases

MHC leases various buildings from Meridian Health Realty Corporation, a subsidiary of MH, under leases that are renewable annually. Rent expense under these leases was \$8,268 and \$8,252 for 2013 and 2012, respectively. The Corporations utilize various types of equipment and space under separate operating leases. The related expenses for the years ended December 31, 2013 and 2012 were approximately \$9,892 and \$11,758, respectively.

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The following is a schedule of the future minimum payments for the remaining years required under operating leases currently in effect:

| | | |
|------------|----|---------------|
| 2014 | \$ | 7,202 |
| 2015 | | 5,960 |
| 2016 | | 4,716 |
| 2017 | | 3,378 |
| 2018 | | 2,365 |
| Thereafter | | 28,576 |
| | \$ | <u>52,197</u> |

10. Line of Credit

MHC renewed its line of credit for \$15,000 with a maturity date of July 2014. As of December 31, 2013, MHC had letters of credit totaling \$9,250 outstanding against this line as collateral for certain insurance policies, therefore, \$5,750 was available for cash demands. The line is evidenced by a promissory note payable to the order of one of MHC's primary banks. Additionally, BCH has letters of credit totaling \$2,180 outstanding as collateral for certain high deductible insurance policies.

11. Pension Plans, Postretirement Health Care and Postemployment Benefits

MHC currently provides retirement benefits for employees through a defined benefit cash balance plan and two 403(b) savings plans. MNR provides for retirement benefits through a frozen 403(b) savings plan and several 401(k) plans. In addition, MHC provides certain postretirement and postemployment benefits. The postretirement and postemployment benefit plans provide health care benefits and life insurance coverage to a limited group of employees. Current employees are not eligible for participation in these plans. As of December 31, 2013 and 2012, liabilities totaling \$1,378 were included in other liabilities related to estimated benefits payable under the postretirement and postemployment plans. Benefits under the postretirement and postemployment benefit plans are paid as incurred.

On December 31, 2009, the defined benefit cash balance plan and existing 403(b) plan were effectively frozen. Any employee eligible to participate in either of these plans on December 31, 2009 will continue to accrue benefits under these plans until retirement. All new employees joining MHC after this date will be eligible to participate in a new 403(b) savings plan.

**Meridian Hospitals Corporation and Meridian Nursing and
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Years Ended December 31, 2013 and 2012

(in thousands)

Defined Benefit Cash Balance Plan

The defined benefit cash balance plan was created on January 1, 1998 through the conversion and merger of predecessor defined benefit plans. Benefits calculated based upon the predecessor plans were frozen as of December 31, 1997. Beginning January 1, 1998 benefits are based upon contributions to participants' accounts at a percentage of the employee's salary.

MHC's funding policy provides that payments to the pension plan shall at least be equal to the minimum funding requirement of the Employee Retirement Income Security Act of 1974 ("ERISA") plus additional amounts, which may be approved by MHC from time to time. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The plan assets consist mainly of cash, mutual funds, fixed income and equities.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
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(in thousands)

The following table sets forth the funded status of the cash balance pension plan as of December 31, 2013 and 2012:

| | 2013 | 2012 |
|--|--------------------|---------------------|
| Change in benefit obligation | | |
| Benefit obligation at beginning of year | \$ 368,359 | \$ 322,254 |
| Service cost | 18,318 | 16,598 |
| Interest cost | 14,905 | 15,834 |
| Actuarial loss (gain) | (20,680) | 28,637 |
| Benefits paid | <u>(14,822)</u> | <u>(14,964)</u> |
| Net benefit obligation at end of year | <u>366,080</u> | <u>368,359</u> |
| Change in plan assets | | |
| Fair value of plan assets at beginning of year | 299,053 | 251,132 |
| Actual return on plan assets | 39,740 | 35,885 |
| Employer contributions | 13,300 | 27,000 |
| Gross benefits paid | <u>(14,822)</u> | <u>(14,964)</u> |
| Fair value of plan assets at end of year | <u>337,271</u> | <u>299,053</u> |
| Funded status at end of year | <u>\$ (28,809)</u> | <u>\$ (69,306)</u> |
| | 2013 | 2012 |
| Amounts recognized in the statements of financial position consist of | | |
| Noncurrent liability | <u>\$ (28,809)</u> | <u>\$ (69,306)</u> |
| Amounts recognized in unrestricted net assets consist of | | |
| Net loss | \$ (55,846) | \$ (101,758) |
| Prior service cost | <u>(1,358)</u> | <u>(1,822)</u> |
| | <u>\$ (57,204)</u> | <u>\$ (103,580)</u> |
| Amounts in unrestricted net assets expected to be recognized in net periodic benefit cost | | |
| Net loss | \$ 6,814 | \$ 7,088 |
| Prior service cost (credit) | <u>465</u> | <u>(467)</u> |
| | <u>\$ 7,279</u> | <u>\$ 6,621</u> |
| Accumulated benefit obligation | <u>\$ 332,805</u> | <u>\$ 331,821</u> |

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
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(in thousands)

| | 2013 | 2012 |
|--|--------|--------|
| Weighted-average assumptions used to determine benefit obligations at December 31, | | |
| Discount rate | 4.80 % | 4.05 % |
| Rate of compensation increase | 4.50 % | 4.50 % |
| Weighted average assumptions used to determine net periodic benefit cost for years ended December 31, | | |
| Discount rate | 4.05 % | 4.85 % |
| Expected return on plan assets | 7.25 % | 7.50 % |
| Rate of compensation increase | 4.50 % | 4.50 % |

The fair value of plan assets for pension plans was in excess of the accumulated benefit obligation at December 31, 2013. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans at December 31, 2013 and 2012 were as follows:

| | 2013 | 2012 |
|---|------------|------------|
| Projected benefit obligation, end of year | \$ 366,080 | \$ 368,359 |
| Accumulated benefit obligation, end of year | 332,805 | 331,821 |
| Fair value of plan assets, end of year | 337,271 | 299,053 |

The net periodic pension cost included the following components:

| | 2013 | 2012 |
|---|--------------------|------------------|
| Service cost | \$ 18,318 | \$ 16,598 |
| Interest cost | 14,905 | 15,834 |
| Expected return on assets | (21,047) | (18,939) |
| Amortization of | | |
| Prior service cost (credit) | 465 | (467) |
| Actuarial loss | 6,814 | 7,088 |
| Net periodic benefit cost | <u>\$ 19,455</u> | <u>\$ 20,114</u> |
| | 2013 | 2012 |
| Other changes in benefits and plan assets | | |
| Current year actuarial (gain) loss | \$ (39,098) | \$ 11,691 |
| Recognition of actuarial loss | (6,814) | (7,088) |
| Recognition of prior service (cost) credit | (465) | 467 |
| Total other changes in benefits and plan assets | <u>\$ (46,377)</u> | <u>\$ 5,070</u> |
| Total net periodic benefit cost and other changes in benefits and plan assets | <u>\$ (26,922)</u> | <u>\$ 25,184</u> |

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Notes to Financial Statements
Years Ended December 31, 2013 and 2012

(in thousands)

Investment Policy

The Pension and Investment Subcommittee is responsible for the formulation and implementation of investment policy for the assets of the Plan and ongoing supervision of the investment process.

The investment policy relates to the composite of the portfolios managed by the investment managers recommended by the investment advisors to the Subcommittee from time to time. The Subcommittee recommendations are forwarded to the Finance Committee and the Board of Trustees of MH for approval. The Subcommittee has constructed guidelines for the investment managers which collectively serve to enact the investment policy for the Plan. Compliance with these guidelines is monitored on an ongoing basis by MH's investment advisors.

Return objectives are outlined by the investment policy and provide a means to evaluate the performance of each individual asset class and the total portfolio. The investment performance is evaluated against the investment objectives on a current quarter, year-to-date, and three-year and five-year basis.

MHC, in consultation with investment advisors, has selected a long term rate of return on plan assets of 7.25%. The rate was determined based upon review of the capital markets' risks and returns. The key determinants for equities are corporate earnings growth, dividend yield and changes in valuation levels. The fixed income projected return is based on the current yield curve, with an adjustment for assumed changes in interest rates. Private equity risk and returns are modeled assuming a leveraged position in small capitalization public equities with a 5.0% annualized performance premium. Commodities returns are forecasted by aggregating three projected components of returns: spot return from a basket of commodities, roll return from managing commodities future contracts and the expected return of collateral represented by cash equivalents. The real estate return forecast method is the sum of the current cash yield, anticipated growth in cash returns and the effect of a potential change in valuation levels.

The capital market assumptions are reviewed on an ongoing basis to ensure that the process for deriving assumptions remains current.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Notes to Financial Statements
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(in thousands)

MHC's asset investment strategy for the Plan focuses on maintaining a diversified portfolio designated to maximize returns while minimizing volatility and risk. The assets are viewed as having a long time horizon with moderate liquidity needs. Therefore, the investment strategy favors a higher commitment to equity securities. Periodically, management completes an asset-liability study for the Plan to determine the optimal asset mix and adjusts investment allocations as needed. The current asset allocation range and targets with actual allocation ranges at December 31, 2013 and 2012 are as follows:

| | Allocation Range | Target Allocation | Percentage of Plan Assets at | |
|----------------------------------|---------------------|----------------------|---------------------------------|------|
| | | | 2013 | 2012 |
| Investment categories | | | | |
| Large-capitalization US equities | 12-32% | 22 % | 30 % | 30 % |
| Small-capitalization US equities | 3-9% | 6 % | 9 % | 8 % |
| International equities | 7-17% | 12 % | 13 % | 16 % |
| Global equity | 5-15% | 10 % | 10 % | 0 % |
| Fixed income | 30-50% | 40 % | 33 % | 40 % |
| Alternative investments | 5-15% | 10 % | 5 % | 6 % |

Fair Value Measurements

The following table sets forth by level, within the fair value hierarchy, the Plan's investments at fair value as of December 31, 2013:

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Inputs Unobservable (Level 3) | Balances at December 31, 2013 |
|------------------------------|---|---|--|-------------------------------------|
| Corporate equity securities | \$ 46,836 | \$ 3,789 | \$ - | \$ 50,625 |
| Mutual funds-equity | - | 90,715 | - | 90,715 |
| Mutual funds-fixed income | - | 35,341 | - | 35,341 |
| Common/collective trust | - | 140,801 | - | 140,801 |
| Alternative investments | - | - | 17,815 | 17,815 |
| Cash and cash equivalents | | | | |
| Short term fixed income fund | - | 1,974 | - | 1,974 |
| Total assets at fair value | <u>\$ 46,836</u> | <u>\$ 272,620</u> | <u>\$ 17,815</u> | <u>\$ 337,271</u> |

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Notes to Financial Statements
Years Ended December 31, 2013 and 2012

(in thousands)

The following table sets forth by level, within the fair value hierarchy, the Plan's investments at fair value as of December 31, 2012:

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Inputs Unobservable (Level 3) | Balances at December 31, 2012 |
|------------------------------|---|---|--|-------------------------------------|
| Corporate equity securities | \$ 34,209 | \$ 3,235 | \$ - | \$ 37,444 |
| Mutual funds-equity | - | 78,261 | - | 78,261 |
| Mutual funds-fixed income | - | 37,403 | - | 37,403 |
| Common/collective trust | - | 124,475 | - | 124,475 |
| Alternative investments | - | - | 17,899 | 17,899 |
| Cash and cash equivalents | - | - | - | - |
| Short term fixed income fund | - | 3,571 | - | 3,571 |
| Total assets at fair value | <u>\$ 34,209</u> | <u>\$ 246,945</u> | <u>\$ 17,899</u> | <u>\$ 299,053</u> |

At December 31, 2013, MHC's remaining outstanding funding commitments to alternative investments approximated \$2,924.

The table below sets forth a summary of the changes in the fair value of the Plan's Level 3 assets for the year ended December 31, 2013 and 2012:

| | Private Equity Funds | Real Estate Funds | Commodities Funds | Total |
|---|-------------------------|----------------------|----------------------|------------------|
| Balance at December 31, 2011 | \$ 6,299 | \$ 5,510 | \$ 4,991 | \$ 16,800 |
| Realized gains | 428 | 1,110 | - | 1,538 |
| Unrealized losses relating to instruments still held at the reporting date | (311) | (175) | (28) | (514) |
| Purchases | 723 | - | - | 723 |
| Sales | - | - | - | - |
| Distributions | (648) | - | - | (648) |
| Balances at December 31, 2012 | <u>6,491</u> | <u>6,445</u> | <u>4,963</u> | <u>17,899</u> |
| Realized gains | 715 | 1,187 | - | 1,902 |
| Unrealized gains (losses) relating to instruments still held at the reporting date | 621 | (1,225) | (390) | (994) |
| Purchases | - | - | - | - |
| Sales | - | - | - | - |
| Distributions | (992) | - | - | (992) |
| Balances at December 31, 2013 | <u>\$ 6,835</u> | <u>\$ 6,407</u> | <u>\$ 4,573</u> | <u>\$ 17,815</u> |

There were no transfers between levels during 2013 and 2012.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
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(in thousands)

Contributions

MHC expects to contribute \$15,000 to its pension plan in 2014.

Estimate Future Benefit Payments

The following benefit payments which reflect future service as appropriate are expected to be paid:

| | | |
|-----------|----|---------|
| 2014 | \$ | 34,192 |
| 2015 | | 22,513 |
| 2016 | | 24,497 |
| 2017 | | 24,644 |
| 2018 | | 27,409 |
| 2019–2022 | | 149,772 |

403(b) Plans

MHC sponsors two 403(b) savings plans. The Meridian 403(b) Savings Plan for Cash Balance Participants was adopted January 1, 1998. An employee is eligible for participation in this plan if the employee was hired prior to January 1, 2010, after attaining the age of 21 and completion of one year of eligible service. Matching contributions will be received after 15 months of eligible service. Total contributions to the 403(b) were approximately \$5,735 and \$5,116 during 2013 and 2012, respectively. The second 403(b) plan is the Meridian 403(b) Savings Plan. An employee is eligible to participate in this plan if the employee was hired on or after January 1, 2010. All employees who are scheduled to work 20 hours or more per week will be eligible to make elective deferrals beginning on the date of hire. Employer matching contributions will begin after attaining the age of 21 and completion of one year of service. Employees will be eligible to receive employer nonelective contributions equal to 3% of compensation immediately. Total contributions for 2013 and 2012 were estimated at \$6,329 and \$2,231, respectively.

MNR sponsors several 401(k) plans ("401(k)") and a money purchase plan. Once an employee has worked 1,000 hours in a calendar year, Meridian matches 100 percent up to 3 percent and 50 percent up to 2 percent of a team member's contribution for Brick, Shrewsbury (nonunion); and Ocean Grove; and matches 100 percent up to 6 percent of pay at Wall. The Shrewsbury Union plan is 100 percent employee funded with no matching contribution. The Shrewsbury Union Money Purchase Plan is an employer funded plan and the employee receives \$0.48 per hour worked. Total contributions to the plans were \$915 and \$773 during 2013 and 2012, respectively.

SOMC sponsors a 403(b) for its employees. All full-time and part-time employees are eligible for participation in the plan upon completion of one year of service. Under the plan, vesting percentages increase by increments of 25% per year. SOMC has a full match on employee contributions up to 2% of compensation and a 50% match for amounts contributed above 2% to a maximum of 7%. Total contributions were \$1,161 for the year ended December 31, 2012. Effective December 31, 2012, the SOMC 403(b) plan was merged into the Meridian 403(b) Savings Plan.

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(in thousands)

BCH Pension Plans

Employees of the BCH who have attained the age of 21, work more than 1,000 hours per year, and have completed one year of service are eligible to participate in a contributory defined contribution pension plan. BCH makes a bi-weekly matching contribution of fifty cents for every dollar an employee contributes in accordance with a scale based on years of service. Employees may contribute from 1% up to 100% of their annual salary up to a maximum of \$15,500 on a pre-tax basis. Total contributions were \$647 for the year ended December 31, 2012. Effective December 31, 2012, the BCH 403(b) plan was merged into the Meridian 403(b) Savings Plan.

BCH is the sponsor of a noncontributory defined benefit pension plan (the "BCH Plan") covering substantially all of BCH's employees. Benefits are based on salary and years of service. As of April 30, 1999, BCH has frozen the Plan to new participants and no benefits will accrue for future services.

BCH recognizes in its balance sheet a liability for the BCH Plan's underfunded status, measures the Plan's assets and obligations as of the end of the fiscal year, and recognizes the periodic change in the funded status of the BCH Plan as a component of changes in unrestricted net assets in the year in which the change occurs. The benefit obligations were \$25,927 and \$27,681 as of December 31, 2013 and 2012, respectively. The fair value of the plan assets were \$24,184 and \$21,162 resulting in the plan being underfunded by \$1,743 and \$6,519 as of December 31, 2013 and 2012, respectively. The Combined Statements of Operations reflect net periodic pension costs of \$379 and \$116 during 2013 and 2012, respectively.

The following assumptions were used in determining the benefit obligations and net periodic benefit costs:

| | December 31, | |
|---|---------------------|-------------|
| | 2013 | 2012 |
| Weighted-average assumptions used to determine benefit obligations | | |
| Discount rate | 4.94 % | 4.21 % |
| Weighted-average assumptions used to determine net periodic benefit cost | | |
| Discount rate | 4.21 % | 5.10 % |
| Expected long-term rate of return on plan assets | 7.25 % | 7.50 % |

To develop the expected long-term rate of return on assets assumption, BCH considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio. This resulted in the selection of the 7.25% expected long-term rate of return on assets. The Plan asset allocation as of December 31, 2013 was 46% domestic equities, 13% international equities, 39% fixed income and 2% alternative investments, which is within the permissible asset class ranges outlined in the investment policy. When market conditions are such that the value of the equity portion of the portfolio exceeds its permissible range, investment managers are instructed, under the direction of the Pension and Investment Subcommittee and with the assistance of the investment advisors, to rebalance the portfolios as appropriate.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
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(in thousands)

BCH's funding policy provides that payments to the BCH Plan shall be equal to the minimum funding requirements of the Employee Retirement Income Security Act of 1974 plus additional amounts which may be approved by BCH from time to time. BCH expects to contribute approximately \$1,177 to the BCH Plan in 2014.

12. Transactions With Affiliated Organizations

The Corporations record transactions with affiliated organizations in the normal course of its operations. The affiliated organizations with significant balances include the following entities. Meridian Health Realty Corporation and Subsidiaries was organized to acquire, construct, finance, operate and own or lease property for the benefit of MH and its affiliated organizations. Meridian Practice Institute, Inc. serves as the management organization for the faculty practice and other physician practice development strategies. Meridian Accountable Care Organization is a partnership among the Corporations' hospitals, partner companies, and over 500 physicians, whose mission includes the promotion of evidence-based medicine, the advocacy of patient engagement, and the development of an infrastructure for network providers to internally report on quality and cost metrics. Meridian Health Foundations have been established to solicit and invest funds for the benefit of the Corporations and any other not-for-profit organization as directed by MH. Meridian Health Management, Inc ("MHM") is a for-profit company whose primary purposes include providing physician practice management services; development and operation of ambulatory surgery centers; recruitment of physicians; and other support services. Meridian Health Ventures, Inc. is a for-profit company providing support services to MH and is the sole member of MHM. SOCH Properties 1, LLC owns and operates property for the benefit of SOMC and its affiliated organizations.

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Notes to Financial Statements
Years Ended December 31, 2013 and 2012

(in thousands)

Amounts due from (to) affiliated organizations consist of the following:

| | December 31, | |
|---|---------------------|-------------------|
| | 2013 | 2012 |
| Current (liabilities) receivable | | |
| Health Innovations Unlimited, Inc. | \$ (10) | \$ (12) |
| Meridian Home Care Services, Inc. | (66) | (30) |
| Meridian Health Management, Inc. | 126 | 80 |
| Meridian Health Realty Corporation and Subsidiaries | (4,027) | (2,944) |
| Meridian Health System, Inc. | (9) | (112) |
| Meridian Practice Institute, Inc. | 3,650 | 736 |
| Affiliated Foundations | 169 | 266 |
| Meridian Accountable Care Organization | 579 | - |
| Other affiliates | (89) | (23) |
| Current receivable (liabilities) | <u>\$ 323</u> | <u>\$ (2,039)</u> |
| Interest in net asset balances | | |
| Meridian Health Foundation, Inc. | \$ 3,952 | \$ 3,881 |
| Jersey Shore University Medical Center Foundation, Inc. | 25,798 | 25,801 |
| Riverview Medical Center Foundation, Inc. | 21,118 | 17,830 |
| Ocean Medical Center Foundation, Inc. | 14,494 | 10,130 |
| Southern Ocean Medical Center Foundation, Inc. | 3,445 | 3,785 |
| Bayshore Community Hospital Foundation, Inc. | 2,757 | 2,456 |
| Interest in net assets balance of foundations | <u>\$ 71,564</u> | <u>\$ 63,883</u> |
| Due from affiliates | | |
| Health Care Management Corporation | \$ - | \$ 8,053 |
| Meridian Health Management, Inc. | 6,622 | - |
| Meridian Health Ventures, Inc. | 1,398 | - |
| SOCH Properties 1, LLC | 810 | 876 |
| Long term receivable | <u>\$ 8,830</u> | <u>\$ 8,929</u> |

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combined Notes to Financial Statements
Years Ended December 31, 2013 and 2012

(in thousands)

MH maintains a risk financing program (the "Program") for its facilities via a wholly owned Bermuda corporation, Coastal Medical Insurance Ltd. ("Coastal") that was formed in 1998. The Program provides funding for various risks including Hospital Professional Liability ("HPL"), General Liability ("GL"), Directors and Officers, Property and Workers' Compensation ("WC"). For 2013 and 2012, the Program provided funding for HPL risks of \$1,000 per occurrence subject to an overall aggregate exposure of \$3,000 and GL risks of \$1,000 per occurrence and in the aggregate. For Workers' Compensation, the Program provided funding for the deductible portion of MH's Worker's Compensation exposure, or \$500 per occurrence. The Corporation has recorded an estimated insurance receivable of \$52,515 and \$40,920 included in other assets in the combined balance sheet as of December 31, 2013 and 2012, respectively. The Corporation has recorded a HPL, GL and WC loss reserve totaling \$55,318 and \$45,380 and a professional liability tail reserve of \$13,017 and \$8,765 included in other liabilities in the combined balance sheet as of December 31, 2013 and 2012, respectively.

In 2006, SOMC entered into an agreement with Southern Ocean Imaging Associates, LLC ("Imaging") to form Health Village Imaging, LLC (the "LLC"). Both SOMC and Imaging have a 50 percent ownership interest in the LLC. In addition, SOMC guarantees 50 percent of the LLC's debt obligations for capital and financing costs. At December 31, 2013 and 2012 the LLC's total outstanding debt obligations were approximately \$576 and \$879, respectively.

During 2012, BCH made a \$2,400 equity transfer to MHC. In addition, MHC made an equity transfer of \$2,400 to Meridian Health System.

During 2013, MHC received a \$1,231 equity transfer from its affiliated foundations. In addition, MHC made a \$6,000 equity transfer to Meridian Health System and a \$1,200 equity transfer to its affiliated foundations.

13. Concentration of Credit Risk

The Corporations grant credit without collateral to its patients, most of whom are local residents and are insured under third party payor agreements. Concentrations of gross accounts receivable from patients and third party payors were as follows:

| | December 31, | |
|--------------------------|---------------------|--------------|
| | 2013 | 2012 |
| Medicare and medicaid | 38 % | 38 % |
| Managed care/HMO | 33 | 33 |
| Other third party payors | 13 | 13 |
| Self-pay patients | 16 | 16 |
| | <u>100 %</u> | <u>100 %</u> |

**Meridian Hospitals Corporation and Meridian Nursing and
Rehabilitation, Inc.**
Combined Notes to Financial Statements
Years Ended December 31, 2013 and 2012

(in thousands)

14. Commitments and Contingencies

Various suits, investigations and claims arising in the normal course of operations are pending or are on appeal against the Corporations. Such suits and claims are either specifically covered by insurance or are not material. While the outcome of these suits cannot be determined with certainty at this time, management believes that any loss which may arise from those suits and claims will not have a material adverse effect on the financial position or results of operations of the Corporations.

15. Subsequent Events

The Corporations performed an evaluation of subsequent events through March 31, 2014 which is the date of the combined financial statements were issued. The Corporations have determined that all events or transactions, including estimates, required to be recognized in accordance with generally accepted accounting principles, are included in the combined financial statements.

Combining Supplemental Schedules

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combining Balance Sheet
December 31, 2013

(in thousands)

| | Meridian Hospitals Corporation | Meridian Nursing & Rehabilitation, Inc. | Eliminating and Combining Entries | Total Combined Financial Statements Meridian Obligated Group |
|---|--------------------------------------|---|--|---|
| Assets | | | | |
| Current assets | | | | |
| Cash and cash equivalents | \$ 186,941 | \$ 9,957 | \$ - | \$ 196,898 |
| Assets limited as to use and short-term investments | 254,960 | 405 | - | 255,365 |
| Patient accounts receivable, net | 117,746 | 10,382 | - | 128,128 |
| Due from affiliates | 4,533 | 6 | (10) | 4,529 |
| Other current assets | 38,238 | 450 | - | 38,688 |
| Total current assets | 602,418 | 21,200 | (10) | 623,608 |
| Assets limited as to use and investments, noncurrent portion | 401,059 | 8,575 | - | 409,634 |
| Property, plant and equipment, net | 725,008 | 57,720 | - | 782,728 |
| Other assets | 67,930 | 4,634 | - | 72,564 |
| Interest in net asset balance of foundations | 71,564 | - | - | 71,564 |
| Due from affiliates | 8,830 | - | - | 8,830 |
| Total assets | \$ 1,876,809 | \$ 92,129 | \$ (10) | \$ 1,968,928 |
| Liabilities and Net Assets | | | | |
| Current liabilities | | | | |
| Current maturities of long-term debt and capital lease obligations | \$ 16,886 | \$ 2,232 | \$ - | \$ 19,118 |
| Accounts payable and accrued expenses | 137,814 | 8,910 | - | 146,724 |
| Estimated amounts due to third party payors | 37,006 | 2,392 | - | 39,398 |
| Due to affiliates | 4,201 | 15 | (10) | 4,206 |
| Other current liabilities | 47,431 | 329 | - | 47,760 |
| Total current liabilities | 243,338 | 13,878 | (10) | 257,206 |
| Long-term debt and capital lease obligations, less current maturities | 537,849 | 49,098 | - | 586,947 |
| Accrued pension liability | 30,552 | - | - | 30,552 |
| Other liabilities | 190,442 | 364 | - | 190,806 |
| Total liabilities | 1,002,181 | 63,340 | (10) | 1,065,511 |
| Net assets | | | | |
| Unrestricted | 803,037 | 28,789 | - | 831,826 |
| Temporary restricted | 50,144 | - | - | 50,144 |
| Permanently restricted | 21,447 | - | - | 21,447 |
| Total net assets | 874,628 | 28,789 | - | 903,417 |
| Total liabilities and net assets | \$ 1,876,809 | \$ 92,129 | \$ (10) | \$ 1,968,928 |

Meridian Hospitals Corporation and Meridian Nursing and Rehabilitation, Inc.
Combining Statement of Operations
December 31, 2013

(in thousands)

| | Meridian Hospitals Corporation | Meridian Nursing & Rehabilitation, Inc. | Eliminating and Combining Entries | Total Combined Financial Statements Meridian Obligated Group |
|--|--------------------------------------|---|--|---|
| Unrestricted revenues, gains and other support | | | | |
| Patient service revenue, net of contractual allowances | \$ 1,316,851 | \$ 95,913 | \$ - | \$ 1,412,764 |
| Less: Provision for bad debts | 76,480 | - | - | 76,480 |
| Net patient service revenue | 1,240,371 | 95,913 | - | 1,336,284 |
| Other revenue | 53,038 | 4,707 | (298) | 57,447 |
| Net assets released from restriction used for operating activities | 2,500 | - | - | 2,500 |
| Total operating revenues | 1,295,909 | 100,620 | (298) | 1,396,231 |
| Expenses | | | | |
| Salaries, wages and contracted labor | 504,789 | 53,153 | - | 557,942 |
| Physician salaries and fees | 47,263 | - | - | 47,263 |
| Employee benefits | 132,837 | 10,267 | - | 143,104 |
| Supplies and other expenses | 457,224 | 31,687 | (298) | 488,613 |
| Depreciation and amortization | 59,183 | 3,224 | - | 62,407 |
| Interest | 31,835 | 728 | - | 32,563 |
| Provision for bad debts | - | 2,823 | - | 2,823 |
| Total expenses | 1,233,131 | 101,882 | (298) | 1,334,715 |
| Income from operations | 62,778 | (1,262) | - | 61,516 |
| Nonoperating revenues | | | | |
| Investment income | 24,271 | 1,057 | - | 25,328 |
| Unrealized gain on derivative instruments | 34,708 | - | - | 34,708 |
| Loss on the extinguishment of debt | (1,356) | - | - | (1,356) |
| Other gains, net | - | 169 | - | 169 |
| Excess of revenue over expenses | 120,401 | (36) | - | 120,365 |
| Change in net unrealized gains on investments | 22,139 | - | - | 22,139 |
| Net assets released from restriction for capital acquisition | 6,951 | - | - | 6,951 |
| Increase (decrease) in net assets before other adjustments | 149,491 | (36) | - | 149,455 |
| Equity transfers from affiliates | (5,969) | - | - | (5,969) |
| Other changes in pension benefits and plan assets | 49,524 | - | - | 49,524 |
| Other changes in unrestricted net assets | 278 | - | - | 278 |
| Increase in unrestricted net assets | \$ 193,324 | \$ (36) | \$ - | \$ 193,288 |