Consolidated Financial Statements

Banner Health and Subsidiaries
Years Ended December 31, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

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Years Ended December 31, 2014 and 2013

Contents

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Report of Independent Auditors

The Board of Directors
Banner Health

We have audited the accompanying consolidated financial statements of Banner Health and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Banner Health and subsidiaries at December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 13, 2015

Banner Health and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2014	**2013**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 67,318**	$ 133,349
Short-term investments	**183,335**	82,302
Collateral held under securities lending program	**143,493**	174,161
Assets limited as to use	**128,465**	138,159
Patient receivables, net of allowance for doubtful accounts of $209,945 in 2014 and $225,531 in 2013	**571,586**	500,513
Inventories	**161,611**	139,685
Other	**145,929**	215,753
Total current assets	**1,401,737**	1,383,922
Assets limited as to use:		
Funds designated by:		
Board of Directors	**1,699,604**	1,635,669
Lease agreements	**4,254**	4,480
Funds held by trustees under:		
Self-insurance funding arrangements	**125,449**	90,041
Indenture agreements	**57,485**	83,052
Other funds	**311,905**	194,716
Total assets limited as to use, less current portion	**2,198,697**	2,007,958
Assets held for sale	**2,140**	2,140
Property and equipment, net	**2,707,986**	2,562,467
Property leased from NCMC, Inc.	**185,312**	187,885
Other assets:		
Long-term investments	**1,980,131**	1,800,818
Deferred financing costs, net	**8,763**	8,246
Other	**333,770**	273,867
Total other assets	**2,322,664**	2,082,931
	$ 8,818,536	$ 8,227,303

	December 31 2014	2013
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Trade accounts payable	**$ 126,480**	$ 117,413
Current portion of long-term debt	**72,342**	48,863
Current portion of lease obligation with NCMC, Inc.	**23,967**	19,728
Payable under securities lending program	**143,493**	174,161
Estimated current portion of third-party payor settlements	**7,346**	22,298
Accrued expenses:		
Salaries and benefits	**280,472**	251,618
Other	**222,268**	244,231
Total current liabilities	**876,368**	878,312
Long-term debt, less current portion	**2,462,310**	2,314,410
Lease obligation with NCMC, Inc.	**155,605**	168,986
Estimated self-insurance liabilities, less current portion	**129,181**	110,161
Estimated third-party payor settlements, less current portion	**14,071**	7,969
Other	**552,832**	380,326
Total liabilities	**4,190,367**	3,860,164
Net assets:		
Unrestricted	**4,475,951**	4,234,708
Temporarily restricted	**127,693**	107,357
Total Banner Health net assets	**4,603,644**	4,342,065
Non-controlling interests – unrestricted	**24,525**	25,074
Total net assets	**4,628,169**	4,367,139
	$ 8,818,536	$ 8,227,303

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Income

	Year Ended December 31	
	2014	**2013**
	(In Thousands)	
Revenues:		
Net patient service	**$ 5,116,229**	$ 4,931,778
Provision for doubtful accounts	**370,246**	507,725
Net patient service revenue, less provision for doubtful accounts	**4,745,983**	4,424,053
Medical insurance premiums	**468,274**	439,732
Other revenue	**183,614**	233,219
Total other operating revenue	**651,888**	672,951
Total revenues	**5,397,871**	5,097,004
Expenses:		
Salaries and benefits	**2,745,952**	2,544,540
Supplies	**863,839**	799,235
Physician and professional fees	**124,439**	114,148
Medical claims cost, net of Banner claims of $226,352 in 2014 and $222,322 in 2013	**214,060**	252,003
Depreciation and amortization	**319,206**	300,952
Interest	**136,021**	131,948
Other	**731,086**	700,078
Total expenses	**5,134,603**	4,842,904
Operating income	**263,268**	254,100
Other income (losses):		
Investment income – realized	**91,730**	128,154
Investment (loss) income – unrealized	**(2,756)**	168,365
Income from alternative investments	**53,735**	107,940
Investment income	**142,709**	404,459
Unrealized (loss) gain on interest rate swaps	**(141,203)**	180,118
Other	**(6,439)**	(5,282)
	(4,933)	579,295
Excess of revenues over expenses	**258,335**	833,395
Less excess of revenues over expenses attributable to non-controlling interest	**19,882**	17,918
Excess of revenues over expenses attributable to Banner Health	**238,453**	815,477
Amortization of cumulative loss on interest rate swaps	**227**	227
(Increase) decrease in unfunded pension liability	**(8,776)**	13,382
Contributions for property and equipment acquisitions	**11,339**	14,020
Increase in unrestricted net assets	**$ 241,243**	$ 843,106

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Changes in Net Assets

	Year Ended December 31	
	2014	**2013**
	(In Thousands)	
Unrestricted net assets:		
Excess of revenues over expenses	**$ 238,453**	$ 815,477
Amortization of cumulative loss on interest rate swaps	**227**	227
(Increase) decrease in unfunded pension liability	**(8,776)**	13,382
Contributions for property and equipment acquisitions	**11,339**	14,020
Increase in unrestricted net assets	**241,243**	843,106
Temporarily restricted net assets:		
Contributions	**42,875**	43,960
Net unrealized gain on investments	**287**	1,091
Net assets released from restrictions for property and equipment additions	**(10,993)**	(7,595)
Net assets released from restrictions for operations	**(11,833)**	(22,808)
Increase in temporarily restricted net assets	**20,336**	14,648
Non-controlling interests:		
Excess of revenue over expenses attributable to non-controlling interests	**19,882**	17,918
Other changes, primarily distributions of earnings to non-controlling interests	**(20,431)**	(20,753)
Decrease in non-controlling interests	**(549)**	(2,835)
Increase in net assets	**261,030**	854,919
Net assets, beginning of year	**4,367,139**	3,512,220
Net assets, end of year	**$ 4,628,169**	$ 4,367,139

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Cash Flows

		Year Ended December 31		
		2014		**2013**
		(In Thousands)		
Operating activities				
Increase in net assets	**$**	**261,030**	$	854,919
Adjustments to reconcile increase in net assets to net cash provided by operating activities:				
Depreciation and amortization		**319,206**		300,952
Increase in investments designated as trading		**(486,739)**		(354,890)
Net unrealized loss (gain) on interest rate swaps		**140,976**		(180,345)
Increase (decrease) in unfunded pension liability		**8,776**		(13,382)
Gain on sale of assets, net		**(686)**		(390)
Contributions for purchase of property and equipment and other		**(11,339)**		(14,020)
Temporarily restricted contributions		**(42,875)**		(43,960)
Changes in operating elements, net of acquisitions and dispositions				
Patient receivables		**(57,262)**		(11,934)
Inventories and other current assets		**51,087**		(122,262)
Accounts payable and accrued expenses		**13,393**		53,735
Estimated third-party payor settlements		**(9,450)**		(3,047)
Estimated self-insurance liabilities		**19,020**		(27,919)
Other liabilities		**(1,275)**		(4,237)
Net cash provided by operating activities		**203,862**		433,220
Investing activities				
Net purchases of property and equipment		**(338,772)**		(390,560)
Decrease in funds held under indenture agreements		**25,567**		81,298
Acquisitions, primarily Regional Care Services Corporation, net of cash acquired of $4,542		**(93,909)**		–
Increase in other assets		**(45,122)**		(25,251)
Net cash used in investing activities		**(452,236)**		(334,513)
Financing activities				
Proceeds from temporarily restricted contributions		**42,875**		43,960
Proceeds from issuance of debt		**297,325**		1,208
Payments of debt issue costs		**(1,090)**		–
Payments of lease obligation with NCMC, Inc.		**(19,873)**		(17,166)
Payments of long-term debt		**(136,894)**		(48,094)
Net cash provided by (used in) financing activities		**182,343**		(20,092)
Net (decrease) increase in cash and cash equivalents		**(66,031)**		78,615
Cash and cash equivalents at beginning of year		**133,349**		54,734
Cash and cash equivalents at end of year	**$**	**67,318**	$	133,349
Supplemental disclosure of cash flow information				
Interest paid, including amounts capitalized	**$**	**138,237**	$	137,684
Non-cash activities				
Increase (decrease) in receivable from Sun Health and related obligation for retirement plan	**$**	**15,271**	$	(20,302)
Capital lease obligation	**$**	**18,214**	$	20,115
Increase in other long-term liability for NCMC contingent rent	**$**	**6,956**	$	–

See accompanying notes.

1. Description of Business

Banner Health is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. Banner Health and its subsidiaries (collectively, Banner) own or lease hospitals, clinics, nursing homes, clinical laboratories, ambulatory surgery centers, home health agencies, a captive insurance company, two foundations, an accountable health care organization (see Note 6), and other health care-related organizations in seven western states. Banner also holds an interest in several health care-related organizations, including the following:

- A 51% controlling interest in Sonora Quest Laboratories (SQL); the financial results of SQL have been included in Banner's consolidated financial statements as of and for the years ended December 31, 2014 and 2013.

- A 50% non-controlling interest in Veritage LLC (Veritage) which is accounted for under the equity method of accounting. The Veritage joint venture was entered into as of September 1, 2012 (see Note 7). Banner's share of Veritage LLC's net income has been recorded within operating revenue for the years ended December 31, 2014 and 2013.

Subsequent events have been evaluated through March 13, 2015, the date of the issuance of the consolidated financial statements. There were no subsequent events requiring recognition in the consolidated financial statements. All non-recognized subsequent events have been disclosed.

2. Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements reflect the consolidated operations of all owned and leased operating units of Banner and its wholly owned subsidiaries. Banner also holds controlling interests in several joint ventures; the joint venture financial results are included within Banner's consolidated financial statements. Banner records the unrelated investor's ownership share of these joint ventures as non-controlling interest. The non-controlling interest balance as of December 31, 2014 and 2013, primarily relates to Banner's investment in SQL.

2. Significant Accounting Policies (continued)

On June 9, 2014, Banner acquired substantially all of the net assets of Regional Care Services Corporation (RCSC). Pursuant to the terms of the transaction, Banner purchased Casa Grande Regional Medical Center, Regional Care Physician's Group, and Casa Grande Regional Medical Center Foundation, located in Casa Grande, Arizona. The purchase price was approximately $93,607,000, which includes approximately $8,624,000 that was advanced to RCSC in 2014 prior to the closing. The transaction did not include acquisition of RCSC's equity investment in Cancer Treatment Services Arizona, Inc.

The RCSC purchase price was allocated to the net tangible assets acquired, based upon their estimated fair values as of June 9, 2014. Results of operations of RCSC have been included in Banner's consolidated financial statements since June 9, 2014. The fair values assigned to assets acquired and liabilities assumed were as follows (in thousands):

Current assets, includes $4,542 in cash received	$ 20,764
Property and equipment	75,564
Other assets	1,434
Current liabilities	(2,677)
Non-current liabilities	(836)
Restricted equity for donor restricted assets	(1,254)
Net assets acquired	$ 92,995

In accordance with the not for profit business combination accounting standards, Banner recorded goodwill of approximately $612,000 relating to the difference between the estimated fair value of net assets assumed and the purchase price.

All significant intercompany accounts and transactions have been eliminated in consolidation.

Fair Values

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value. The fair values of other financial instruments are disclosed in their respective notes.

2. Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and highly liquid marketable securities with an original maturity of three months or less when purchased by Banner.

Short-Term Investments

Short-term investments include debt securities with maturity dates of one year or less from the balance sheet date and actively traded equity securities that are expected to be used on a short-term basis for working capital needs. These investments are stated at fair value, based on quoted market prices in active markets.

Investments

Investment income, including interest and dividends, realized gains and losses on investments, unrealized gains and losses on investments, and income on alternative investments, is included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

Banner invests in various investment securities that are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the consolidated financial statements.

Banner uses derivative financial instruments in its investment portfolio to moderate changes in value due to fluctuations in the financial markets. Banner has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in the fair value of derivatives is recognized as a component of investment income as described above.

2. Significant Accounting Policies (continued)

Banner invests in alternative investments, mainly hedge funds, through limited partnerships. As of December 31, 2014 and 2013, Banner has recorded approximately $1,263,590,000 and $1,167,092,000, respectively, in alternative investments primarily within other long-term investments. Banner accounts for its ownership interests in these alternative investments under the equity method of accounting based on the net asset value per share of the fund held by Banner. The hedge fund net asset value is provided to Banner by each of the hedge fund managers. The net asset value is determined based on the estimated fair value of each of the underlying investments held in the hedge fund. However, the hedge fund investment holdings may include investments in private investment funds whose values have been estimated by the hedge fund managers in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market for these investments existed. The investment income recorded is based on Banner's proportionate share of the hedge fund portfolio net asset value. The alternative investment income is primarily recorded within income from alternative investments on the consolidated statement of income, with the remainder recorded as a change to restricted net assets for those funds that have been restricted by the donor. Banner has recorded approximately $53,735,000 and $107,940,000 of alternative investment unrestricted realized and unrealized gain for the years ended December 31, 2014 and 2013, respectively. The restricted share of alternative investment realized and unrealized income is approximately $290,000 and $239,000 for the years ended December 31, 2014 and 2013, respectively. As of December 31, 2014, approximately $489,115,000 of alternative investments were subject to a one-year redemption lockup period, and approximately $61,407,000 were subject to a two-year redemption lockup period.

Banner offsets the fair value for various derivative instruments such as forwards, interest rate swaps, currency swaps, options, and other conditional or exchange contracts, if they are executed with the same counterparty, under a master netting arrangement. Banner invests in a variety of derivative instruments through a fixed income manager that has executed a master netting arrangement with each of its forward and future purchase and sale contracts, interest and credit swap agreements, and options, whereby the financial instruments are held by the same counterparty and are legally offset as the instrument is settled. Banner's derivative contracts in a net loss position were reported on a net basis on the accompanying consolidated balance sheets as of December 31, 2014 and 2013. As of December 31, 2014, the gross derivative assets and liabilities held and netted together within the investment accounts amounted to assets of approximately $594,027,000 and liabilities of approximately $602,907,000, respectively. As of December 31, 2013, the gross derivative assets and liabilities held and netted together within the investment accounts amounted to assets of approximately $670,488,000 and liabilities of approximately $667,187,000, respectively (see Note 4).

2. Significant Accounting Policies (continued)

Banner has entered into several repurchase agreements amounting to approximately $13,900,000 and $6,941,000 as of December 31, 2014 and 2013, respectively, which are included in long-term investments on the accompanying consolidated balance sheets. In connection with the repurchase agreements, Banner has loaned cash to certain financial institutions in exchange for collateral. Collateral provided by these financial institutions amounted to approximately $14,192,000 and $6,775,000 as of December 31, 2014 and 2013, respectively.

Assets Limited as to Use

Assets limited as to use include marketable securities that have been designated for use as determined by the Banner Board of Directors, such as for property and equipment replacement and expansion, payments under lease and loan agreements, assets held by trustees under self-insurance funding and indenture agreements, and assets held as collateral by counterparties under interest rate swap agreements.

Securities Lending Program

Banner participates in securities lending transactions through its custodian whereby Banner lends a portion of its investments to various brokers in exchange for collateral for the securities loaned, usually on a short-term basis. Collateral provided by the brokers consists of cash and securities and is maintained at levels approximating 102% of the fair value of the securities on loan, adjusted for market fluctuations. Banner maintains effective control of the loaned securities through its custodian during the term of the arrangement in that they may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. The value of collateral held for loaned securities is reported in current assets as collateral held under securities lending program, and a corresponding obligation is reported in current liabilities as a payable under securities lending program in the accompanying consolidated balance sheets. At December 31, 2014 and 2013, the fair value of the collateral provided on behalf of Banner was approximately $143,493,000 and $174,161,000, respectively. At December 31, 2014 and 2013, the fair market value of securities on loan was approximately $139,843,000 and $169,975,000, respectively, and is included in assets limited as to use on the accompanying consolidated balance sheets.

2. Significant Accounting Policies (continued)

Net Patient Accounts Receivable

Net patient accounts receivable and net patient service revenues have been adjusted to the estimated amounts expected to be received based on contractual rates for services rendered. These estimated amounts are subject to further adjustments upon review by third-party payors. Management estimates the provision for doubtful accounts and the allowance for doubtful accounts for each major payor based upon the historical collection experience of each facility. Banner evaluates a patient’s ability to pay for patient services based on an entity-wide assessment and as part of this assessment has determined that management does not have the ability to assess the patient’s ability to pay for the majority of self-pay patients, and accordingly, any patient account write off is recorded within the provision for doubtful accounts as a reduction of patient service revenue. Management regularly reviews payment data for each major payor in evaluating the sufficiency of the allowance for doubtful accounts. During 2014, Banner experienced a shift from self-pay patient revenue to Medicaid patient revenue as a result of the Arizona Medicaid Restoration program enacted by Arizona Health Care Cost Containment System (AHCCCS). The increase in AHCCCS patients, from self-pay, is attributable to certain changes in eligibility requirements that the AHCCCS program enacted in 2014. These changes, as well as a shift in insurance coverage due to the establishment of the state insurance exchange under the Affordable Care Act, resulted in a decrease to the provision for doubtful accounts from approximately $507,725,000 in 2013 to approximately $370,246,000 in 2014.

Inventories

Inventories, consisting principally of supplies, are stated at the lower of cost or market, determined on a first-in, first-out basis.

Property and Equipment

Property and equipment are stated at cost, if purchased or at fair value on the date received, if donated, less accumulated depreciation and amortization.

Amortization is provided on a straight-line basis over the shorter of the lease period or the estimated useful lives for leasehold improvements. Depreciation is provided on a straight-line basis over the estimated useful lives of the property and equipment, which range from 2 to 40 years.

2. Significant Accounting Policies (continued)

Long-Lived Asset Impairment

Banner reviews long-lived assets, other than goodwill, for impairment when events or changes in business conditions indicate that their carrying values may not be recoverable. Banner considers assets to be impaired and writes them down to fair value if expected undiscounted cash flows are less than the carrying amounts. Fair value is the present value of the associated discounted cash flows. Banner has determined that there was no impairment of long-lived assets at December 31, 2014 or 2013.

Goodwill

Purchases of acquired businesses have been allocated to the assets and liabilities acquired based on the estimated fair values on the respective acquisition dates. Based on these values, the excess purchase price over the fair value of the net assets acquired was allocated to goodwill.

Banner evaluates goodwill for impairment at least annually and more frequently if certain indicators are encountered. Goodwill is tested at the reporting unit level, defined as an operating segment or one level below an operating segment (referred to as a component), with the fair value of the reporting unit being compared to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to be impaired.

Banner completes its annual impairment test during the fourth quarter using a qualitative assessment to determine whether there are events or circumstances that indicate it is more likely than not that the reporting units' fair values are less than their carrying amounts. Banner determined that there was no goodwill impairment for 2014, however, a goodwill impairment charge of approximately $3,559,000 was recorded for the year ended December 31, 2013, within operating expenses.

Costs of Borrowing

Debt issuance costs are deferred and amortized over the terms of Banner's bonds using the straight-line method, which approximates the effective interest method.

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

2. Significant Accounting Policies (continued)

Self-Insurance Programs

In connection with self-insurance programs, accounts have been established for the purpose of accumulating assets based on actuarial determinations. These assets can be used only for the payment of professional liability, general liability, workers' compensation, employment liability, employee group life insurance claims, and related expenses. It is Banner's policy to record the expense and related liability for professional liability, general liability, workers' compensation, employment liability, and employee group life insurance losses based upon undiscounted actuarial estimates.

Contributions

Banner records contributions upon receipt of an unconditional promise to give, less an allowance for doubtful accounts. Gifts, bequests, and other promises or receipts restricted by donors as to use or time period are recorded as temporarily restricted net assets until used in the manner designated or upon expiration of the time period restriction. Donated property and equipment are recorded at fair value at the date received. Unrestricted contributions received are recorded as other income.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by Banner has been limited by donors to a specific time period or purpose.

Performance Indicator

Banner's performance indicator is the excess of revenues over expenses, which includes all changes in unrestricted net assets other than changes in the amortization of cumulative loss on interest rate swaps through March 31, 2007 (see Note 8), contributions for property and equipment acquisitions, and changes to unfunded pension liability.

2. Significant Accounting Policies (continued)

Net Patient Service Revenue

Banner has agreements with third-party payors that provide for payments at amounts different from its established rates. Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered. Contractual adjustments resulting from agreements with various organizations to provide services for amounts that differ from billed charges, including services under the Medicare, Medicaid, and certain managed care programs, are recorded as deductions within net patient service revenue. Banner recognizes that revenue from government agencies and managed care organizations is significant to Banner's operations, but management does not believe that there are any significant credit risks associated with these payors. A summary of the payment arrangements with major third-party payors follows.

Medicare

Approximately 22.3% in 2014 and 21.2% in 2013 of Banner's net patient service revenue was derived from the Medicare program. Most inpatient acute care and 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 and diagnostic factors. Teaching facility programs related to Medicare beneficiaries and services provided at critical access hospitals to Medicare beneficiaries are paid based on a cost reimbursement methodology. Banner is 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. Medicare cost reports for the acute care hospitals through December 31, 2010, and for the critical access hospitals through December 31, 2011, have been settled with the Medicare fiscal intermediary as of December 31, 2014. The estimated settlement for Medicare cost report years 2011 through 2014 (acute hospitals) and 2012 through 2014 (critical access hospitals) has been recorded as estimated third-party payor settlements on the accompanying consolidated balance sheets.

Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded third-party payor settlement estimates will change by a material amount in the near term as cost report adjustments become known or as cost report years are no longer subject to such audit.

2. Significant Accounting Policies (continued)

Medicaid

Approximately 11.5% and 9.1% in 2014 and 2013, respectively, of Banner's net patient service revenue was derived from various state Medicaid programs. Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid according to the terms of the state program under which services are provided, which may allow for reimbursement based on per diem rates, percentage of eligible charges, cost reimbursement, or prospectively determined based on clinical and diagnostic factors. Certain Medicaid payments are subject to final settlement after audit by fiscal intermediaries.

During 2012, the Centers for Medicare and Medicaid Services (CMS) approved direct and indirect graduate medical education payments to Banner pursuant to a Medicaid state plan amendment submitted by AHCCCS. In connection with this plan amendment, Banner recorded approximately $19,305,000 and $32,720,000 in 2014 and 2013, respectively, which has been recorded as to an increase to net patient service revenue.

In connection with the AHCCCS Medicaid Restoration program described above, certain hospitals within the state of Arizona were required to pay a hospital assessment fee to assist with the funding of the increased Medicaid costs. For the year ended December 31, 2014, Banner paid approximately $65,000,000 in AHCCCS hospital assessment fees that is recorded within other expenses.

Other Third-Party Payors

Banner has also entered into payment agreements with certain commercial insurance carriers and health maintenance organizations. The bases for payment under these agreements include prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem and capitated rates. Approximately 61.2% in 2014 and 61.1% in 2013 of Banner's net patient service revenue was derived from other third-party payors.

2. Significant Accounting Policies (continued)

Self-Pay

Approximately 5.0% in 2014 and 8.6% in 2013 of Banner's net patient service revenue was derived from self-pay patients. Self-pay includes patients without insurance and patients with deductibles and coinsurance associated with third-party payor coverage. For self-pay patients that do not qualify for charity care, Banner recognizes revenue on the basis of uninsured discounted or standard rates. Banner records a provision for doubtful accounts related to self-pay patients, at the time services are provided, based on historical collection experience.

City of Phoenix Access to Care Tax

In April 2013, CMS approved a new Access to Care Tax, under which Banner hospitals located in Phoenix were assessed a tax which was used by the City of Phoenix to draw federal Medicaid matching funds to partially compensate hospitals with high levels of uncompensated care for care provided to uninsured and low income patients from a safety net care pool established by Arizona statute under AHCCCS. For the year ended December 31, 2013, Banner paid approximately $51,818,000 under the Phoenix provider tax assessment that is recorded within other expense. For the year ended December 31, 2013, eligible Banner hospitals received approximately $98,502,000 from the safety net care pool, which is recorded as an increase to net patient service revenue. In April 2014, Banner hospitals received the final payment under this program amounting to approximately $13,607,000, which is recorded as an increase to net patient service revenue.

Medical Insurance Premiums and Medical Claim Costs

Banner Health Network (BHN) has entered into contracts with insurance companies whereby BHN receives a monthly capitation premium and is responsible for the payment of the enrolled members claim payments. For the years ended December 31, 2014 and 2013, BHN recorded premium revenue from insurance companies and CMS of approximately $468,274,000 and $439,732,000, respectively. BHN paid health care claims for services rendered to enrolled members of approximately $440,412,000 and $474,325,000 as of December 31, 2014 and 2013, respectively. The medical claims costs reported on the consolidated statements of income is net of intercompany eliminations for services rendered at Banner facilities and providers, amounting to approximately $226,352,000 and $222,322,000, for the years ended December 31, 2014 and 2013, respectively.

2. Significant Accounting Policies (continued)

Electronic Health Records Incentive Payments

Beginning in 2011, the Medicare and state Medicaid programs provide incentive payments to eligible hospitals and professionals if meaningful use certified electronic health care (EHR) technology is adopted and utilized. The incentive payments are recognized when management is reasonably assured that Banner has complied with the conditions set forth by Medicare and Medicaid and has demonstrated meaningful use of its EHR technology for the applicable attestation period. Approximately $13,300,000 and $39,429,000 in Medicare and Medicaid incentive payments were recognized in other revenue for the years ended December 31, 2014 and 2013, respectively. Banner's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, EHR incentive payments are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were initially calculated.

Charity Care and Services that Benefit the Community

In furtherance of its charitable purpose, Banner provides a broad range of benefits to the communities it serves, including offering various community-based social service programs and a number of health-related educational programs. These services are designed and provided to improve the general standards of health for the communities.

Included in services to the communities are programs directed at the poor and persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. Non-elective, medically necessary care provided by Banner is rendered regardless of the patient's ability to pay, and Banner's charity care policy offers various discounts from billed charges based on the patient's family's income. Because Banner does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

In addition to providing traditional charity care, Banner assumes the unpaid costs of Medicaid and other indigent public programs; provides services for the community through health promotion and education, health clinics, and screenings, all of which cannot be billed or can be operated only on a deficit basis; assumes the unpaid costs of training health professionals, such as medical residents, nursing students, and students in allied health professions; provides community health research; and provides cash and in-kind donations of equipment, supplies, or staff time made on behalf of the community.

2. Significant Accounting Policies (continued)

Banner's cost accounting system is used to quantify the estimated charity care costs, which include both direct and indirect costs, for providing patient care at each facility. During 2014 and 2013, costs incurred by Banner in the provision of charity care, the unpaid costs of programs directed at the poor, the education of health professionals, research activities, and the costs of supporting other community programs were approximately $456,815,000 and $444,195,000, respectively. Charity care is recorded based on the cost of services provided for which charges are written off in accordance with Banner's charity care policy, but does not include the amount, if any, for which the patient remains responsible.

The following summary of Banner's net community benefit for the years ended December 31 represents services to both the poor and broader community:

	2014	**% of Total Expense**	**2013**	**% of Total Expense**
	(In Thousands)		*(In Thousands)*	
Traditional charity care, at cost	**$ 83,778**	**1.6%**	$ 153,070	**3.2%**
Unpaid cost of public programs, Medicaid, and other indigent care programs	**305,723**	**6.0**	227,261	**4.7**
Health professional education	**26,256**	**0.5**	23,412	**0.5**
Community health services	**7,327**	**0.2**	7,878	**0.2**
Research activities	**11,096**	**0.2**	11,069	**0.2**
Community-building activities	**1,391**	**–**	2,134	**–**
Subsidized health services	**16,818**	**0.3**	16,678	**0.3**
Contributions and in-kind donations	**4,340**	**0.1**	2,551	**0.1**
Community benefit operations	**86**	**–**	142	**–**
Total cost of community benefit	**456,815**	**8.9**	444,195	**9.2**
Unpaid cost of Medicare	**78,397**	**1.5**	75,759	**1.6**
Total cost of community benefit and the unpaid cost of Medicare	**$ 535,212**	**10.4%**	$ 519,954	**10.8%**

Traditional Charity Care is the cost of services for which reimbursement is not pursued, in accordance with Banner's policy to provide health care services free of charge or on a discounted fee schedule to those who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured.

2. Significant Accounting Policies (continued)

Unpaid Costs of Public Programs is the shortfall created when Banner receives payments below the cost for patients enrolled in publicly supported programs such as Medicaid.

Health Professional Education includes the unpaid costs of training health professionals, such as medical residents, nursing students, and students in allied health professions.

Community Health Services include costs for health education and related activities designed to improve the health of the community. Community health education programs, community-based clinical services, and health care support services are included. No patient bills are generated for these services.

Research Activities include clinical and community health research as well as studies on health care delivery.

Community-Building Activities include the costs of programs that develop the community through physical improvements, economic development, support system enhancements, environmental improvements, leadership development, coalition building, community health improvement advocacy, and workforce enhancement.

Subsidized Health Services include costs for billed services that are subsidized by Banner. These include services offered despite a financial loss because they are needed in the community and either other providers are unwilling to provide the services or the services would otherwise be unable to meet patient demand.

Contributions and In-Kind Donations include cash donations, grants, and in-kind donations to the community-at-large and other tax-exempt organizations.

Community Benefit Operations include costs of directly planning, evaluating, and managing community benefit activities.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Significant Accounting Policies (continued)

For the years ended December 31, 2014 and 2013, the provision for doubtful accounts decreased by approximately $46,000,000 and $42,000,000, respectively, for outside collection recoveries on patient receivables previously written off. Net patient service revenue increased in 2014 and 2013, by approximately $22,000,000 and $10,000,000, respectively, for changes in estimates related to third-party payor settlements, including appeals, associated with the Medicare program. Revenue increased in 2014 and 2013, by approximately $25,000,000 and $16,000,000, respectively, for certain BHN contract settlements (see Note 6). In addition, BHN claims expense decreased by $10,000,000 in 2014 as a result of positive claim experience for the 2013 contract year.

For the three months ended December 31, 2014, Banner recorded an increase to other revenue of approximately $18,000,000 relating to EHR incentive payments. For the three months ended December 31, 2013, Banner recorded an increase to other revenue of approximately $14,000,000 relating to EHR incentive payments. Additionally in 2013, other revenue increased by approximately $12,000,000 for an investment that was previously recorded within temporarily restricted net assets due to restrictions placed on the investment; however, in October 2013, the investee released the restriction resulting in the investment value being recorded as an increase to other revenue.

New Accounting Pronouncements

In May 2014, as part of its ongoing efforts to assist in the convergence of U.S. GAAP and International Financial Reporting Standards the Financial Accounting Standards Board (FASB) issued a new accounting standard, *Revenue from Contracts with Customer*s, which amends current revenue recognition guidance. Under the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the accounting standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard is effective for Banner on January 1, 2017. Management is currently evaluating the impact of adopting the accounting standard.

In June 2014, the FASB issued a new accounting standard, *Repurchase to Maturity Transactions, Repurchase Financings and Disclosures*, which requires repurchase to maturity transactions to be accounted for as secured borrowings. The accounting standard also requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty and also requires additional disclosures relating to

2. Significant Accounting Policies (continued)

repurchase transactions. The new standard was effective for Banner on January 1, 2015. Management is currently evaluating the impact of adopting the accounting standard.

Reclassifications

The 2013 consolidated financial statements have been reclassified to conform to the 2014 presentation, primarily relating to the presentation of BHN claims costs for amounts paid to Banner facilities, which resulted in an increase to net patient service revenue, and a corresponding increase to medical claims costs, of approximately $12,000,000.

3. Concentrations of Credit Risk

Banner grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of December 31 was as follows:

	2014	**2013**
Commercial, HMO, PPO, and other third-party payors	**43.7%**	46.3%
Medicare	**32.7**	32.9
Medicaid and AHCCCS	**16.4**	11.8
Self-pay	**7.2**	9.0
	100.0%	100.0%

4. Fair Value Measurements

Fair value is defined as an 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 should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, Banner utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Pricing inputs into the determination of fair value are generally observable inputs such as quoted prices in active markets. Financial assets in Level 1 primarily include listed equities.

4. Fair Value Measurements (continued)

- *Level 2* – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in Level 2 include asset-backed securities, mortgage-backed securities, collateralized mortgage obligations, U.S. Treasury securities, corporate bonds and loans, forward contracts, interest and credit swap agreements, options, and interest rate swap obligations.

- *Level 3* – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates. Financial assets in Level 3 include alternative investments held in the defined benefit plan.

Assets and liabilities measured at fair value are based on one or more of the three valuation techniques identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

(a) *Market approach* – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities

(b) *Cost approach* – Amount that would be required to replace the service capacity of an asset or liability (replacement cost)

(c) *Income approach* – Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option pricing, and excess earnings models)

4. Fair Value Measurements (continued)

Banner's investment in alternative investments, amounting to approximately $1,263,590,000 and $1,167,092,000 as of December 31, 2014 and 2013, respectively, is accounted for using the equity method of accounting. Accordingly, the alternative investments are omitted from the following schedule of financial instruments measured at fair value. Of Banner's alternative investments, approximately $1,247,235,000 are reported in long-term investments and $16,355,000 are reported in Banner Health Foundation restricted funds as of December 31, 2014, and $1,155,142,000 are reported in long-term investments and $11,950,000 are reported in Banner Health Foundation restricted funds as of December 31, 2013. Also included in assets limited as to use are premium payments to be received from Banner's split-dollar life insurance policies amounting to approximately $23,725,000 and $28,230,000 as of December 31, 2014 and 2013, respectively, which are not measured at fair value. There have not been any changes in any of the investments' fair value level classification, between Level 1 and Level 2, in 2014 or 2013.

4. Fair Value Measurements (continued)

	December 31 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
	(In Thousands)				
Short-term investments:					
Cash and cash equivalents	$ 183,254	$ 183,254	$ –	$ –	a
Commercial paper	3	–	3	–	a
Asset-backed securities	3	–	3	–	a
Commercial mortgage-backed securities	3	–	3	–	a
Government mortgage-backed securities	16	–	16	–	a
Non-government-backed collateralized mortgages	3	–	3	–	a
Corporate bonds	13	–	13	–	a
U.S. Treasury/government obligations	40	–	40	–	a
Total short-term investments	$ 183,335	$ 183,254	$ 81	$ –	
Collateral held under securities lending program:					
Cash and cash equivalents	$ 143,493	$ 143,493	$ –	$ –	a
Total collateral held under securities lending program	$ 143,493	$ 143,493	$ –	$ –	
Assets limited as to use:					
Cash and cash equivalents	$ 395,343	$ 395,343	$ –	$ –	a
Commercial paper	5,006	–	5,006	–	a
Equities	1,275,378	1,275,378	–	–	a
Asset-backed securities	42,360	448	41,912	–	a
Commercial mortgage-backed securities	13,059	208	12,851	–	a
Government mortgage-backed securities	124,014	92,726	31,288	–	a
Non-government-backed collateralized mortgages	25,597	–	25,597	–	a
Corporate bonds/non-U.S. government bonds	168,783	69,634	99,149	–	a
U.S. Treasury/government obligations	253,897	52,291	201,606	–	a
Total assets limited as to use	$ 2,303,437	$ 1,886,028	$ 417,409	$ –	
Long-term investments:					
Cash and cash equivalents	$ 24,098	$ 24,098	$ –	$ –	a
Commercial paper	2,478	–	2,478	–	a
Equities	323,915	323,915	–	–	a
Asset-backed securities	41,397	–	41,397	–	a
Commercial mortgage-backed securities	11,318	–	11,318	–	a
Government mortgage-backed securities	19,881	–	19,881	–	a
Non-government-backed collateralized mortgages	19,139	–	19,139	–	a
Corporate bonds/non-U.S. government bonds	75,834	5,250	70,584	–	a
Repurchase agreements	13,900	–	13,900	–	a
U.S. Treasury/government obligations	200,936	55,130	145,806	–	a
Total long-term investments	$ 732,896	$ 408,393	$ 324,503	$ –	
Interest rate swaps included in other long-term liabilities	$ (356,607)	$ –	$ (356,607)	$ –	c
Banner Health Foundation restricted funds:					
Cash and cash equivalents	$ 760	$ 760	$ –	$ –	a
Commercial paper	7	–	7	–	a
Mutual funds	3,573	3,573	–	–	a
Equities	25,667	25,667	–	–	a
Asset backed securities	2,852		2,852	–	a
Commercial mortgage backed securities	731	–	731	–	a
Government mortgage backed securities	801	–	801	–	a
Non-government-backed collateralized mortgages	633	–	633	–	a
Corporate bonds	3,318	88	3,230	–	a
U.S. Treasury/government obligations	6,339	–	6,339	–	a
Total Banner Health Foundation restricted funds	$ 44,681	$ 30,088	$ 14,593	$ –	

4. Fair Value Measurements (continued)

	December 31 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
		(In Thousands)			
Short-term investments:					
Cash and cash equivalents	$ 78,189	$ 78,189	$ –	$ –	a
Equities	89	89	–	–	a
Asset-backed securities	187	–	187	–	a
Commercial mortgage-backed securities	91	–	91	–	a
Government mortgage-backed securities	432	–	432	–	a
Non-government-backed collateralized mortgages	200	–	200	–	a
Corporate bonds	789	–	789	–	a
U.S. Treasury/government obligations	2,325	–	2,325	–	a
Total short-term investments	$ 82,302	$ 78,278	$ 4,024	$ –	
Collateral held under securities lending program:					
Cash and cash equivalents	$ 174,161	$ 174,161	$ –	$ –	a
Total collateral held under securities lending program	$ 174,161	$ 174,161	$ –	$ –	
Assets limited as to use:					
Cash and cash equivalents	$ 287,321	$ 287,321	$ –	$ –	a
Equities	1,228,877	1,228,877	–	–	a
Asset-backed securities	19,778	–	19,778	–	a
Commercial mortgage-backed securities	9,654	–	9,654	–	a
Government mortgage-backed securities	87,956	42,160	45,796	–	a
Non-government-backed collateralized mortgages	21,136	–	21,136	–	a
Corporate bonds/non-U.S. government bonds	176,151	92,599	83,552	–	a
U.S. Treasury/government obligations	287,014	40,786	246,228	–	a
Total assets limited as to use	$ 2,117,887	$ 1,691,743	$ 426,144	$ –	
Long-term investments:					
Cash and cash equivalents	$ 9,016	$ 9,016	$ –	$ –	a
Equities	342,034	342,034	–	–	a
Asset-backed securities	9,569	–	9,569	–	a
Commercial mortgage-backed securities	4,670	–	4,670	–	a
Government mortgage-backed securities	22,157	–	22,157	–	a
Non-government-backed collateralized mortgages	10,226	–	10,226	–	a
Corporate bonds/non-U.S. government bonds	39,949	2,995	36,954	–	a
Repurchase Agreements	6,941	–	6,941	–	a
U.S. Treasury/government obligations	201,114	85,455	115,659	–	a
Total long-term investments	$ 645,676	$ 439,500	$ 206,176	$ –	
Interest rate swaps included in other long-term liabilities	$ (215,631)	$ –	$ (215,631)	$ –	c
Banner Health Foundation restricted funds:					
Cash and cash equivalents	$ 453	$ 453	$ –	$ –	a
Equities	24,115	24,115	–	–	a
Asset backed securities	87	–	87	–	a
Commercial mortgage backed securities	43	–	43	–	a
Government mortgage backed securities	202	–	202	–	a
Non-government-backed collateralized mortgages	93	–	93	–	a
Corporate bonds	5,780	5,412	368	–	a
U.S. Treasury/government obligations	11,620	10,535	1,085	–	a
Total Banner Health Foundation restricted funds	$ 42,393	$ 40,515	$ 1,878	$ –	

4. Fair Value Measurements (continued)

Included within short-term investments, assets limited as to use, long-term investments, and Banner Health Foundation restricted funds are mutual funds amounting to approximately $1,067,084,000 and $1,066,113,000 as of December 31, 2014 and 2013, respectively. The mutual funds are recorded at fair value based on quoted prices in active markets. The mutual funds are invested primarily in international, global, and U.S. large cap and small cap equities, as well as U.S. fixed income securities.

Banner received restricted pledges and contributions amounting to $42,875,000 and $43,960,000 for the years ended December 31, 2014 and 2013, which were subject to fair value measurement on a nonrecurring basis. The restricted contributions were measured based on the actual cash received, or for pledges receivable, using discounted cash flow projections. Approximately $1,675,000 and $8,865,000 of the restricted contributions were recorded as pledges receivable as of December 31, 2014 and 2013, respectively.

4. Fair Value Measurements (continued)

Included within short-term investments, assets limited as to use, and other long-term investments are the following gross derivative instruments, recorded at fair value as of December 31:

	December 31 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
		(In Thousands)			
Derivative assets:					
Future contracts	**$ 384,957**	**$ 384,957**	**$ –**	**$ –**	**a**
Forward contracts	**194,680**	**–**	**194,680**	**–**	**a**
Interest rate swap agreements	**8,486**	**–**	**8,486**	**–**	**c**
Option agreements	**1,760**	**–**	**1,760**	**–**	**a**
Net credit swaps	**4,144**	**–**	**4,144**	**–**	**a**
Total derivative assets	**$ 594,027**	**$ 384,957**	**$ 209,070**	**$ –**	
Derivative liabilities:					
Future contracts	**$ (384,957)**	**$ (384,957)**	**$ –**	**$ –**	**a**
Forward contracts	**(193,906)**	**–**	**(193,906)**	**–**	**a**
Interest rate swap agreements	**(21,077)**	**–**	**(21,077)**	**–**	**c**
Option agreements	**(2,345)**	**–**	**(2,345)**	**–**	**a**
Net credit swaps	**(622)**	**–**	**(622)**	**–**	**a**
Total derivative liabilities	**$ (602,907)**	**$ (384,957)**	**$ (217,950)**	**$ –**	

	December 31 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
		(In Thousands)			
Derivative assets:					
Future contracts	$ 357,208	$ 357,208	$ –	$ –	a
Forward contracts	306,529	–	306,529	–	a
Interest rate swap agreements	4,789	–	4,789	–	c
Option agreements	432	–	432	–	a
Net credit swaps	1,530	–	1,530	–	a
Total derivative assets	$ 670,488	$ 357,208	$ 313,280	$ –	
Derivative liabilities:					
Future contracts	$ (357,208)	$ (357,208)	$ –	$ –	a
Forward contracts	(306,299)	–	(306,299)	–	a
Interest rate swap agreements	(1,280)	–	(1,280)	–	c
Option agreements	(786)	–	(786)	–	a
Net credit swaps	(1,614)	–	(1,614)	–	a
Total derivative liabilities	$ (667,187)	$ (357,208)	$ (309,979)	$ –	

4. Fair Value Measurements (continued)

Investment income consisted of the following for the years ended December 31:

	2014	2013
	(In Thousands)	
Interest and dividend income	**$ 55,822**	$ 42,377
Net realized gain on sales of investments	**48,298**	83,623
Income gain from alternative investments, including amount recorded in restricted equity	**54,025**	108,179
Net realized (loss) gain on sales of future contracts	**(1,810)**	23
Net realized loss on sales of interest rate swap agreements	**(4,906)**	(400)
Net realized gain on sales of option agreements	**3,105**	875
Net realized (loss) gain on sales of net credit swaps	**(1,065)**	229
Net unrealized gain on investments	**805**	170,246
Net unrealized (loss) gain on interest rate swap agreements	**(3,165)**	72
Net unrealized (loss) gain on option agreements	**(290)**	146
Net unrealized loss on net credit swaps	**(86)**	(1,190)
	150,733	404,180
Less investment gain (loss) credited to other revenue, restricted equity, and capitalized bond project funds	**8,024**	(279)
Investment income, net	**$ 142,709**	$ 404,459

5. Property and Equipment

Property and equipment consisted of the following as of December 31:

	2014	2013
	(In Thousands)	
Land and land improvements	**$ 268,466**	$ 248,662
Buildings and fixed equipment	**3,158,618**	2,844,658
Major movable equipment	**2,060,678**	1,902,761
Construction-in-progress	**133,190**	191,770
	5,620,952	5,187,851
Less accumulated depreciation and amortization	**2,912,966**	2,625,384
Property and equipment, net	**$ 2,707,986**	$ 2,562,467

6. BHN Accountable Care Organization

BHN is a corporation that has Banner, Banner Medical Group (a wholly owned subsidiary of Banner), Banner Physician Hospital Organization (BPHO), and an unrelated physician network as its members. BHN has established a provider network that primarily consists of Banner facilities, Banner Medical Group, the physicians in the BPHO network, and physicians in the unrelated physician network. BHN has executed contracts with each of the provider network members that outline the payment fee schedule that each of the providers will receive for services rendered to the enrolled members of the BHN contracts as well as the allocation methodology related to the distribution of any incentive payments.

BHN continued its contract with CMS as a Pioneer Accountable Care Organization (Pioneer ACO). This contract was initially awarded January 1, 2012. The Pioneer ACO is a shared-savings model in which participating organizations are eligible for additional payments from CMS if they are able to achieve medical cost savings as compared to certain benchmarks while providing high-quality, coordinated patient care for an assigned group of Medicare beneficiaries. Participants also share risk with CMS for any increase in medical cost and will be required to pay CMS for a portion of any cost increases over certain benchmarks. The risk share for both the medical cost savings and medical cost increases are measured based on a predetermined benchmark for the assigned beneficiary population. Also, medical cost savings under the Pioneer ACO are earned only if certain quality and administrative measures are met.

In 2014, BHN received approximately $9,038,000 from CMS as its share of the 2013 plan year savings, and in 2013, BHN received approximately $13,370,000 from CMS for its share of the 2012 plan year savings. BHN recorded the $9,038,000 and $13,370,000 as other revenue for the years ended December 31, 2014 and 2013, respectively, as BHN was not certain that they had met all of the compliance and quality measures to record the risk share savings prior to receiving the settlement from CMS. BHN has received claim data from CMS for the year ended December 31, 2014, and has initially estimated a risk share receivable from CMS as of December 31, 2014, for the 2014 plan year. However, BHN has not recorded a risk share receivable for the 2014 plan year in the accompanying consolidated financial statements as BHN is not yet able to determine whether compliance with the quality and administrative measures have been achieved.

Certain of the BHN contracts cover members enrolled in a Medicare Advantage Plan. CMS provides additional reimbursement to Medicare Advantage Plans for services rendered to enrolled members that have a higher level of acuity than initially projected. This additional payment, entitled risk adjustment factor (RAF), is paid annually to the Medicare Advantage Plans after the member claim data is analyzed. For the year ended December 31, 2014, BHN

6. BHN Accountable Care Organization (continued)

recorded approximately $14,289,000 as an increase to premium revenue for RAF payments relating to the 2013 contract year and approximately $13,940,000 in estimated RAF payments to be received for the 2014 contract year.

BHN also operates a narrow provider network which contracts with multiple commercial insurance companies during 2014 and 2013. For three of the insurance company contracts, BHN has been delegated claim responsibility. Accordingly, BHN receives a monthly capitation payment directly from the insurance company and is responsible for the claim payments owed to the provider and physician care network. As of December 31, 2014 and 2013, BHN has recorded a claim payable, within other accrued expenses, associated with claims incurred but not yet paid of approximately $34,701,000 and $43,103,000, respectively. For the remaining insurance company contracts, the claim payments are the responsibility of the contracting insurance company. For these plans, BHN receives a care management fee on a per member per month basis and/or shares in the overall financial performance of the plan with the insurance company.

7. Other Non-current Assets

Non-current assets consisted of the following as of December 31:

	2014	2013
	(In Thousands)	
Donor-restricted assets	**$ 131,021**	$ 113,192
Goodwill, net of accumulated amortization of $19,573 in 2014 and 2013	**73,124**	72,230
Investments in unconsolidated affiliates	**69,026**	48,668
Due from Sun Health Services	**49,223**	29,869
Other	**11,376**	9,908
Total other non-current assets	**$ 333,770**	$ 273,867

Included in investments in unconsolidated affiliates is Banner's 50% investment in Veritage for approximately $22,763,000 and $24,316,000 as of December 31, 2014 and 2013, respectively.

7. Other Non-current Assets (continued)

Banner is a member of Premier Inc.'s (Premier) group purchasing organization and in connection with this membership Banner holds a non-controlling interest in Premier that is accounted for under the equity method of accounting. During 2014, Banner purchased additional Class B units from another member of Premier's group purchasing organization, which resulted in Banner holding 2,626,727 and 2,356,727 Class B shares in Premier as of December 31, 2014 and 2013, respectively. In October 2013, Premier completed an initial public offering (IPO) and a restructuring of the company. In connection with the IPO and restructuring, Premier purchased a portion of Banner's Class B Units for approximately $11,382,000. Banner recorded a $10,534,000 gain on the sale of the Class B units within realized investment income for the year ended December 31, 2013. Banner also has the ability to convert its Class B Units into cash or Premier's Class A Common Stock over a seven-year vesting period. The Class B Units in Premier are only held by members of Premier's group purchasing organization whereby Premier serves as their primary supply vendor. Accordingly, each member receives a vendor incentive for the right to exchange their Class B Units for Class A Common Stock over the seven-year vesting period as long as the member participates in Premier's group purchasing organization. The estimated value of the vendor incentive, representing the difference between Premier's Class A Common Stock and Banner's Class B Unit carrying value, is being amortized over the seven-year vesting period as a reduction to supply expense. Banner's equity investment in Premier was approximately $16,529,000 and $4,453,000 and Banner's cumulative vendor incentive was approximately $12,504,000 and $2,900,000 as of December 31, 2014 and 2013, respectively. Banner's share of Premier's net income recorded under the equity method of accounting and Class B units vendor incentive was approximately $12,794,000 in 2014 and $2,900,000 in 2013 and is recorded as a reduction to supply expense.

In a prior year, Sun Health Services, Sun Health Foundation, Sun Health Properties, Inc., and their controlled affiliates (collectively, Sun Health Services) entered into an agreement to provide an annual contribution, calculated under the terms of the agreement and, subject to certain contractual limitations and conditions, to support projects at the facilities acquired from Sun Health Services or at other future Banner projects in the northwestern section of the Phoenix metropolitan area. Sun Health Services committed to contributions of approximately $16,457,000 in 2014 and $8,404,000 in 2013 to Banner, primarily for approved capital purchases. Sun Health Services contributions for approved capital expenditures are recorded as temporarily restricted donations, and once expended, are reclassified into unrestricted net assets. Due from Sun Health Services relates to monies to be received for the completion of approved capital projects at Banner Del E. Webb Hospital and Banner Boswell Hospital and to fund a defined benefit pension obligation (see Note 11) in accordance with the terms outlined in the acquisition agreement.

8. Long-Term Debt

Long-term debt consisted of the following as of December 31:

	2014	2013
	(In Thousands)	
Revenue Bonds, Series 2014A, interest 4.00% to 5.00%, due through 2044	**$ 200,600**	$ –
Revenue Bonds, Series 2012A, interest 3.75% to 5.00%, due through 2043	**179,090**	179,090
Taxable Revenue Bonds, Series 2012B, interest 4.16%, due 2030	**67,840**	67,840
Series 2012 Bank of America obligation, interest 1.91%, due through 2019	**17,680**	21,405
Revenue Bonds, Series 2008A, interest 5.00% to 5.25%, due 2035	**209,675**	212,120
Direct Purchase Rate Securities Revenue Bonds, Series 2008B, interest determined monthly, due through 2035	**88,300**	90,150
Direct Purchase Rate Securities Revenue Bonds, Series 2008C, interest determined monthly, due through 2035	**88,300**	90,150
Revenue Bonds, Series 2008D, interest 5.00% to 6.00%, due through 2038	**754,195**	771,265
Weekly Rate Securities Revenue Bonds, Series 2008E, interest determined weekly, due through 2029	**112,310**	115,635
Weekly Rate Securities Revenue Bonds, Series 2008F, interest determined weekly, due through 2029	**92,090**	94,795
Weekly Rate Securities Revenue Bonds, Series 2008G, interest determined weekly, due through 2029	**86,900**	89,455
Weekly Rate Securities Revenue Bonds, Series 2008H, interest determined weekly, due through 2029	**67,905**	69,900
Revenue Bonds, Series 2007A, interest 5.00%, due through 2025	**135,350**	144,900
Index Rate Bonds, Series 2007B, interest determined quarterly, due through 2037	**400,000**	400,000
Other	**34,417**	16,568
	2,534,652	2,363,273
Less current portion	**72,342**	48,863
Total long-term debt, less current portion	**$ 2,462,310**	$ 2,314,410

8. Long-Term Debt (continued)

Scheduled maturities of debt for the years ending December 31 and thereafter are as follows (in thousands):

2015	$ 72,342
2016	52,797
2017	55,213
2018	57,733
2019	60,285
Thereafter	2,236,282
	$ 2,534,652

Total interest incurred was approximately $140,679,000 and $140,663,000 in 2014 and 2013, respectively, of which $4,658,000 and $8,715,000 was capitalized in 2014 and 2013, respectively. Included within interest costs is approximately $12,842,000 and $12,932,000 of interest expense related to the NCMC, Inc. lease obligation in 2014 and 2013, respectively (see Note 13).

Series 2014A Bonds

In October 2014, Banner issued $200,600,000 of Series 2014A tax-exempt revenue bonds. The proceeds of the bonds will fund construction of Banner Fort Collins Medical Center, and construction projects at Banner MD Anderson Cancer Center and Banner Casa Grande Medical Center. The Series 2014A bonds are fixed-rate securities, bearing interest at an annual rate ranging from 4.00% to 5.00%, and are due in annual installments beginning in 2039 through 2044. The average interest rate for the year ended December 31, 2014, was 4.50%.

The Series 2014A bonds are governed by a Master Indenture covering substantially all of Banner’s indebtedness and obligations under swap agreements. Banner is the sole member of the Obligated Group under the Master Indenture.

Series 2012 Bonds (Series A and B)

In November 2012, Banner issued $179,090,000 of Series 2012A tax-exempt revenue bonds. The proceeds of the bonds were used to fund construction projects at Banner Estrella Medical Center and Banner Baywood Medical Center. The Series 2012A bonds are fixed-rate securities,

8. Long-Term Debt (continued)

bearing interest at an annual rate ranging from 3.75% to 5.00%, and are due in annual installments beginning in 2039 through 2043. The average interest rate for the years ended December 31, 2014 and 2013, was 4.09%.

In December 2012, Banner issued $67,840,000 of Series 2012B taxable revenue bonds. The proceeds of the bonds were used to legally defease a portion of the Series 2008D bonds amounting to $67,190,000. The Series 2012B bonds are fixed-rate securities, bearing interest at an annual rate of 4.16%, and are due in one annual installment in 2030. The average interest rate for the years ended December 31, 2014 and 2013 was 4.16%.

The Series 2012 bonds are governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

Series 2008 Bonds (Series A through H)

In April 2008, Banner issued $227,160,000 Series 2008A tax-exempt revenue bonds. The proceeds of these bonds were used to refund debt. The Series 2008A bonds are fixed-rate securities, bearing interest at an annual rate ranging from 3.25% to 5.25%, and are due in annual installments beginning in 2009 through 2035. The average interest rate for the years ended December 31, 2014 and 2013, was approximately 5.07%.

In June 2008, Banner issued $197,500,000 Series 2008B-C tax-exempt revenue bonds. The proceeds of these bonds were used to refund debt. The Series 2008B-C bonds were issued as variable-rate demand securities bearing interest based on successive interest rate periods of seven days at an interest rate determined by the remarketing agent. Until August 28, 2012, security for the payment of the Series 2008B-C bonds was provided for with a direct pay letter of credit with The Bank of Nova Scotia.

On August 29, 2012, Banner converted the Series 2008B-C bonds to a direct purchase index mode. To effect this conversion, Banner called the bonds effective August 29, 2012, and simultaneously entered into a $91,950,000 Direct Purchase Agreement for the Series 2008B bonds with JP Morgan Chase, N.A. and a $91,950,000 Direct Purchase Agreement for the Series 2008C bonds with Union Bank, N.A. The Direct Purchase Agreement maintains the original payment amortization schedules, will not be assigned a separate rating by any rating agency, or registered with The Depository Trust Company or any other securities depository. The Direct

8. Long-Term Debt (continued)

Purchase Agreement expires on August 29, 2022. The average interest rate for the years ended December 31, 2014 and 2013, was approximately 1.01% and 1.04%, respectively. The Series 2008B-C bonds are due in annual installments through 2035.

In August 2008, Banner issued $917,860,000 Series 2008D tax-exempt revenue bonds. The proceeds of these bonds were used to acquire certain assets of Sun Health Corporation, finance capital projects, and refund debt. The Series 2008D bonds are fixed-rate securities, bearing interest at an annual rate ranging from 5.00% to 6.00%, and are due in annual installments through 2038. The average interest rate for the years ended December 31, 2014 and 2013, was approximately 5.38% and 5.37%, respectively.

In September 2008, Banner issued $397,085,000 Series 2008E-H tax-exempt revenue bonds. The proceeds of these bonds were used to refund debt. The Series 2008E-H bonds are variable-rate demand securities and bear interest based on successive interest rate periods of seven days at an interest rate determined by a remarketing agent. The Series 2008E-H bonds are due in annual installments through 2029. The average interest rate for the years ended December 31, 2014 and 2013, was approximately 0.06% and 0.09%, respectively. Security for the payment of the Series 2008E-H bonds is provided for with direct pay letters of credit with the following banks: Bank of America, N.A. provides credit for the Series 2008E; JPMorgan Chase, N.A. provides credit for the Series 2008F; Wells Fargo, N.A. provides credit for the Series 2008G credit; and The Northern Trust Company provides credit for the Series 2008H. All of the direct pay letters of credit terminate between July 2017 and July 2019. There were no advances outstanding as of December 31, 2014.

The Series 2008 bonds are governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

Series 2007 Bonds (Series A and B)

In May 2007, Banner issued $590,920,000 Series 2007A-B tax-exempt revenue bonds. The proceeds of these bonds were used to finance capital projects.

The Series 2007A bonds are fixed-rate securities due in annual installments through 2025. The bonds bear interest at an annual fixed rate of 5.00%.

8. Long-Term Debt (continued)

The Series 2007B bonds are index-rate bonds due in annual installments beginning in 2025 through 2037. The bonds bear interest computed quarterly based on the three-month London Interbank Offered Rate (LIBOR) rate as determined by the index agent. The average interest rate for the years ended December 31, 2014 and 2013, was 0.97% and 1.00%, respectively.

The Series 2007 bonds are governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

Series 1998A Bonds/Series 2012 Bank of America Term Loan

In November 1998, Banner issued $115,325,000 Series 1998A refunding tax-exempt revenue bonds, of which $82,340,000 of the Series 1998A bonds were issued as serial bonds due in annual installments through 2012, and $32,985,000 were issued as term bonds due in 2028. In 2002, Banner legally defeased the Series 1998A2, A4, and A5. Escrow funds were established to pay the outstanding obligations and the bonds were redeemed on January 1, 2008.

On June 6, 2012, Banner called the remaining outstanding Series 1998A bonds amounting to $27,780,000. Simultaneously, Banner entered into a $27,780,000 taxable fixed-rate loan with Bank of America, N.A. (term loan). The term loan has the same payment amortization schedule as the Series 1998A with a final maturity date of January 1, 2019. The average interest rate for 2014 and 2013 was approximately 1.91%.

The term loan is governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

Interest Rate Swap Agreements

2005 Swaps

In March 2005, Banner entered into multiple interest rate swap contracts that effectively converted the variable rate of certain bonds into fixed rates of 3.661% or 3.690%, depending upon the stated maturity of the swaps (the 2005 Swaps). The original notional amount of the 2005 Swaps was $601,230,000. Banner restructured the 2005 Swaps in 2008, removing the insurance and increasing the fixed rate to 3.676% or 3.705%.

8. Long-Term Debt (continued)

The 2005 Swaps qualified for hedge accounting under standards for accounting for derivative instruments and hedging activities until the April 1, 2007, implementation of derivative instruments and hedging activities accounting guidance that made certain items specifically ineligible for designation as hedge items or transactions. As a result of the hedging designation change, the accumulated unrealized derivative loss of $5,324,000 at March 31, 2007, is being amortized into excess of revenues over expenses over the 27-year remaining life of the 2005 Swaps.

The derivative mark-to-market adjustments resulted in an unrealized loss of approximately $25,377,000 and an unrealized gain of approximately $50,478,000 in 2014 and 2013, respectively, recorded in excess of revenues over expenses. The net realized portion of the interest rate swaps, recorded as an increase to interest expense, in 2014 and 2013 was approximately $19,244,000 and $19,250,000, respectively.

Banner's obligations under the 2005 Swap agreements are governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

2006 Swaps

In March 2006, Banner entered into two forward swap agreements (the 2006 Swaps) with an initial notional amount of $425,000,000. The 2006 Swaps qualified for hedge accounting under standards for accounting for derivative instruments and hedging activities until the April 1, 2007, implementation of derivative instruments and hedging activities accounting guidance that made certain items specifically ineligible for designation as hedge items or transactions. The 2006 Swaps were amended and extended in May 2007 to be used with any of Banner's future debt offerings. In May 2011, Banner began paying interest at a fixed rate of 3.71% against a floating rate of 61.8% of one-month LIBOR plus 31 basis points. As a result of the hedging designation change, the accumulated unrealized derivative loss of $1,072,000 at March 31, 2007, is being amortized into excess of revenues over expenses over the 33-year remaining life of the 2006 Swaps.

The derivative mark-to-market adjustments resulted in an unrealized loss of approximately $67,513,000 and an unrealized gain of approximately $69,053,000 in 2014 and 2013, respectively, recorded in excess of revenues over expenses. The net realized portion of the interest rate swaps in 2014 and 2013, recorded as an increase to interest expense, was approximately $14,211,000 and $13,926,000, respectively.

8. Long-Term Debt (continued)

Banner's obligations under the 2006 Swap agreements are governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

2007 Swaps

In May 2007, Banner entered into two interest rate swaps (the 2007 Swaps) that effectively convert the $400,000,000 LIBOR-based index rate Series 2007B bonds to a fixed rate of 4.413% against a floating rate of 67% of three-month LIBOR plus 81 basis points. The agreements hedged initial notional amounts of $400,000,000 and are reduced over the term of the agreements. The interest rate swaps did not qualify for hedge accounting treatment under standards for accounting for derivative instruments and hedging activities. The derivative mark-to-market adjustments resulted in an unrealized loss of approximately $48,950,000 and an unrealized gain of approximately $59,933,000 for 2014 and 2013, respectively, recorded in excess of revenue over expenses. The net realized portion of the interest rate swaps in 2014 and 2013, recorded as an increase to interest expense, was approximately $13,776,000 and $13,667,000, respectively.

Banner's obligations under the 2007 Swap agreements are governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

Loveland Medical Enterprise Swap

In November 2003, Loveland Medical Enterprise, LLC (now owned by Banner) entered into an interest rate swap contract that effectively converted the variable rate loan into a fixed rate of 6.84%. The original notional amount of the swap was $17,765,000 and is reduced over the term of the agreement which expired on January 20, 2015. The interest rate swap did not qualify for hedge accounting treatment under standards for accounting for derivative instruments and hedging activities. The derivative mark-to-market adjustments resulted in an unrealized gain of $637,000 and $654,000 for 2014 and 2013, respectively, recorded in excess of revenue over expenses. The net realized portion of the interest rate swaps in 2014 and 2013, recorded as an increase to interest expense, was approximately $651,000 and $688,000, respectively.

Each of the interest rate swap agreements, except the Loveland Medical Enterprise Swap, has collateral posting thresholds based on the counterparties' bond ratings. At the AA- rating level, Banner and its counterparty must post collateral when the mark-to-market exceeds between $35,000,000 and $75,000,000, depending on the counterparty. At December 31, 2014 and 2013, Banner had $215,007,000 and $102,505,000 of collateral outstanding with its counterparties,

8. Long-Term Debt (continued)

respectively. The fair value of the collateral is reported as assets limited as to use – other funds in the accompanying consolidated balance sheets.

Bond Indentures

The Master Indenture, as supplemented, contains covenants that, among other matters, restrict the transfer of assets and require the maintenance of specified levels of cash on hand and compliance with certain other financial ratios. Pursuant to the Master Indenture, as supplemented, Banner has pledged its gross revenues to secure all indebtedness and other obligations governed by the Master Indenture. Banner was in compliance with these covenants as of December 31, 2014.

Under the terms of the bond indentures, periodic deposits are made to a trustee-held fund to meet interest and principal payments. Trustee-held funds are included as assets limited as to use in the accompanying consolidated balance sheets. As disclosed for each bond issue, security for the payment of principal and interest of certain series of bonds is provided for with direct pay letters of credit.

Revolving Line of Credit

On September 1, 2009, Banner entered into a $75,000,000 revolving line of credit with JPMorgan Chase, N.A. The line of credit was extended on June 5, 2014, and expires on September 30, 2016. As of December 31, 2014, there were no draws on the line of credit; however, $16,441,000 of the line of credit is being used as a letter of credit with the U.S. Department of Health and Human Services that expires December 31, 2015.

Banner's obligations with respect to the revolving line of credit are governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

Letters of Credit

Banner has the following letters of credit outstanding: Travelers Indemnity Company of Illinois in the amount of $810,000, expiring January 16, 2016; Sentry Insurance in the amount of $3,250,000, expiring January 1, 2016; Humana in the amount of $1,326,000, expiring November 19, 2015; City of Fort Collins in the amount of $829,000, expiring October 31, 2015; Wells Fargo in the amount of $374,000, expiring August 11, 2015; Liberty Mutual in the amount

8. Long-Term Debt (continued)

of $215,000, expiring April 20, 2015; and Zurich America Insurance Company in the amount of $3,300,000, expiring October 31, 2015. No amounts were drawn upon the letters of credit as of December 31, 2014.

Fair Value of Debt and Interest Rate Swaps

As of December 31, 2014 and 2013, the estimated fair value of Banner's debt was $2,582,848,000 and $2,272,790,000, respectively. The estimated fair value is based on quoted market prices for these issues or, where such prices are not available, on current interest rates for debt with similar remaining maturities.

As of December 31, 2014 and 2013, the estimated fair value of the 2005 Swaps resulted in an imputed obligation of $99,576,000 and $74,394,000, respectively, which is recorded in other long-term liabilities in the accompanying consolidated balance sheets. The fair value of the 2005 Swaps is based on the forward LIBOR curve with a blended average duration of approximately 10 years.

As of December 31, 2014 and 2013, the estimated fair value of the 2006 Swaps resulted in an imputed obligation of $143,109,000 and $75,628,000, respectively, which is recorded in other long-term liabilities in the accompanying consolidated balance sheets. The fair value of the 2006 Swaps is based on the forward LIBOR curve with a blended average duration of approximately 25 years.

As of December 31, 2014 and 2013, the estimated fair value of the 2007 Swaps resulted in an imputed obligation of $113,891,000 and $64,941,000, respectively, which is recorded in other long-term liabilities in the accompanying consolidated balance sheets. The fair value of the interest rate swaps is based on the forward LIBOR curve with a blended average duration of approximately 19 years.

As of December 31, 2014 and 2013, the estimated fair value of the Loveland Medical Enterprise Swap resulted in an imputed obligation of $31,000 and $668,000, respectively, which is recorded in other long-term liabilities in the accompanying consolidated balance sheets. The interest rate swap terminated on January 20, 2015.

9. Estimated Self-Insurance Liabilities

Banner has obtained insurance through a combination of purchased and self-insurance programs for professional and general liability claims, workers' compensation claims, and employee group term life insurance. Banner is self-insured for workers' compensation in Arizona and Colorado. Banner facilities outside of Arizona and Colorado are insured for workers' compensation by a commercial insurance company with a deductible of $500,000 per occurrence. Banner is also required to contribute to certain states' mandated workers' compensation programs.

Under its self-insured professional and general liability, workers' compensation and employee group term life insurance programs, Banner contributes actuarially determined amounts to Banner Indemnity, Ltd., a captive insurance company wholly owned by Banner, to fund estimated ultimate losses. In connection with the professional and general liability and workers' compensation self-insurance program, Banner has accrued estimates for asserted and incurred but not reported claims. The actuarially determined claim liabilities amount to $182,546,000 and $177,965,000, of which $60,321,000 and $75,471,000 have been recorded as other current liabilities in the accompanying consolidated balance sheets as of December 31, 2014 and 2013, respectively. Self-insurance liabilities are undiscounted at December 31, 2014 and 2013.

The self-insured, occurrence-based coverage had a per-claim limit of $10,000,000 in 2014 and 2013 and applies to all entities for general and professional liability claims. Individual professional liability claims in excess of the $10,000,000 self-insured retention and aggregate general liability claims in excess of the $10,000,000 self-insured retention are insured through claims-made excess liability policies. The first $25,000,000 of this excess coverage is also self-insured through Banner Indemnity, Ltd. The balance of this excess coverage is provided through reinsurance policies issued by unaffiliated third-party insurers. These excess policies, together with the self-insured components, were in force with aggregate coverage of $225,000,000 for professional and general liabilities as of December 31, 2014.

10. Non-current Liabilities

Other noncurrent liabilities consisted of the following as of December 31:

	2014	2013
	(In Thousands)	
Liability for interest rate swaps	**$ 356,607**	$ 215,631
Non-current employee benefit liabilities	**74,150**	61,275
Banner Health retirement income plan	**20,937**	15,174
Sun Health Services pension plan	**37,312**	22,041
Asset retirement obligation	**14,736**	14,115
Other	**49,090**	52,090
Total other non-current liabilities	**$ 552,832**	$ 380,326

11. Retirement Plans

Defined Contribution Plan

Substantially all of Banner's eligible employees may elect to participate in Banner's defined contribution plan. Employees may contribute up to 21% of eligible compensation, subject to plan restrictions. Banner may provide a matching contribution equal to the first 4% of eligible compensation contributed for each participant, as defined under the defined contribution plan. Contribution expense was $53,846,000 and $50,479,000 for the years ended December 31, 2014 and 2013, respectively.

Defined Benefit Plan

Banner Health Retirement Income Plan

Banner has a non-contributory defined benefit plan (the Plan) that provides certain eligible employees with retirement and death benefits. Banner annually contributes amounts to the Plan as necessary to meet the Employee Retirement Income Security Act of 1974 minimum funding requirements. Benefits are based on years of service and the employee's compensation during the last five years of employment. Benefit accruals under the Plan have been frozen since 2002.

11. Retirement Plans (continued)

The following table sets forth the benefit obligation and assets of the Plan at December 31 (using measurement dates as of December 31, 2014 and 2013, respectively) and components of net periodic benefit costs for the years ended December 31:

	2014	2013
	(In Thousands)	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	**$ 76,528**	$ 86,383
Interest cost	**3,259**	3,123
Actuarial loss (gain)	**9,116**	(6,154)
Benefits paid	**(6,827)**	(6,824)
Projected benefit obligation at end of year	**82,076**	76,528
Change in plan assets		
Fair value of plan assets at beginning of year	**61,354**	56,451
Actual return on plan assets	**1,297**	7,507
Employer contributions	**5,315**	4,220
Benefits paid	**(6,827)**	(6,824)
Fair value of plan assets at end of year	**61,139**	61,354
Funded status – accrued benefit recorded	**$ (20,937)**	$ (15,174)
Unrecognized net loss recorded in net assets	**$ 53,449**	$ 44,673

The actuarial loss recorded in 2014 was primarily due to Banner using new mortality tables in the projected benefit obligation calculation. The new mortality tables were issued by the Society of Actuaries during 2014.

11. Retirement Plans (continued)

The underfunded status of the Plan of $20,937,000 and $15,174,000 at December 31, 2014 and 2013, respectively, is included in other long-term liabilities in the accompanying consolidated balance sheets. No plan assets are expected to be returned to Banner during the year ended December 31, 2015.

	2014	2013
	(In Thousands)	
Components of net periodic benefit cost		
Interest cost	**$ 3,259**	$ 3,124
Expected return on plan assets	**(4,124)**	(3,750)
Amortization of actuarial loss	**2,076**	2,696
Net periodic benefit cost	**$ 1,211**	$ 2,070

The assumptions used to determine the projected benefit obligation for the Plan as of December 31 are set forth below:

	2014	2013
Weighted average discount rate	**3.92%**	4.55%
Weighted average expected long-term rate of return on Plan assets	**7.00%**	7.00%

The assumptions used to determine the net periodic benefit cost for the Plan for the years ended December 31 are set forth below:

	2014	2013
Weighted average discount rate	**4.55%**	3.75%
Weighted average expected long-term rate of return on Plan assets	**7.00%**	7.00%

11. Retirement Plans (continued)

The expected long-term rate of return on Plan assets is based on historical and projected rates of return for current and planned asset categories in the Plan's investment portfolio. Assumed projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category using benchmark rates. Based on the target asset allocation among the asset categories, the overall expected rate of return for the portfolio was developed and adjusted for historical and expected experience of active portfolio management results compared to benchmark returns and for the effect of expenses paid from Plan assets.

The Plan's asset allocation and investment strategies are designed to earn returns on Plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, sectors, and manager style to minimize the risk of large losses. Derivatives may be used to bridge specific exposure, reduce transaction costs, or modify the portfolio's duration or yield. Banner uses investment managers specializing in each asset category and, where appropriate, provides the investment manager with specific guidelines that include allowable and/or prohibited investment types. Banner regularly monitors manager performance and compliance with investment guidelines.

Banner's overall investment strategy is to achieve a mix of approximately 60% of investments for long-term growth and 40% for near-term benefit payments with a wide diversification of asset types, fund strategies, and fund managers. The target allocations for plan assets are 50% equity securities, 30% fixed-income securities, and 20% alternative investments. Equity securities include U.S. and international investments and range from large-cap to small-cap companies. Fixed-income securities include corporate bonds of companies from diversified industries, mortgage-backed securities, and U.S. Treasuries. Alternative investments include mainly hedge funds that invest in several different strategies.

11. Retirement Plans (continued)

The fair value of the Plan's assets at December 31, 2014, by asset category, is as follows:

	December 31 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
		(In Thousands)			
Asset category					
Registered investment company funds:					
U.S. funds	**$ 24,898**	**$ 24,898**	**$ –**	**$ –**	**a**
International funds	**17,429**	**17,429**	**–**	**–**	**a**
Alternative investments	**12,841**	**–**	**–**	**12,841**	**a, c**
Common/collective trust funds	**5,146**	**–**	**5,146**	**–**	**a**
U.S. government securities	**825**	**–**	**825**	**–**	**a**
	$ 61,139	**$ 42,327**	**$ 5,971**	**$ 12,841**	

The fair value of the Plan's assets at December 31, 2013, by asset category, is as follows:

	December 31 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
		(In Thousands)			
Asset category					
Registered investment company funds:					
U.S. funds	$ 9,599	$ 9,599	$ –	$ –	a
International funds	19,421	19,421	–	–	a
Alternative investments	12,127	–	–	12,127	a, c
Common/collective trust funds	1,040	–	1,040	–	a
U.S. government securities	19,167	–	19,167	–	a
	$ 61,354	$ 29,020	$ 20,207	$ 12,127	

11. Retirement Plans (continued)

The table below summarizes the changes in fair value of the Plan's Level 3 assets for the years ended December 31, 2014 and 2013 (in thousands):

Balance at January 1, 2013	$ 11,033
Net appreciation in fair value of investments	1,094
Balance at December 31, 2013	12,127
Net appreciation in fair value of investments	**714**
Balance at December 31, 2014	**$ 12,841**

As of December 31, 2014, the Plan participated in a securities lending program through its custodian whereby the Plan lends a portion of its investments to brokers in exchange for collateral for the securities loaned. The fair value of the collateral provided by the broker approximated $174,000 and $225,000 as of December 31, 2014 and 2013, respectively. The collateral was considered a Level 1 asset under the fair value hierarchy and is valued using the market approach. At December 31, 2014 and 2013, the fair market value of securities on loan was approximately $170,000 and $221,000, respectively.

Information about the expected cash flows for the Plan follows (in thousands):

Expected employer contributions in 2015	$ 4,999,000
Expected benefit payments:	
2015	5,584,000
2016	5,589,000
2017	5,634,000
2018	5,685,000
2019	5,654,000
2020–2024	27,167,000

Sun Health Pension Plan

Under the terms of the agreement for the purchase of Sun Health Services, Banner assumed sponsorship of the Sun Health Pension Plan, a defined benefit plan, and the Sun Health Pension Plan Trust (the Trust). Sun Health Services retained the obligation to fund any required contributions to the Trust to meet the Employee Retirement Income Security Act of 1974 minimum funding requirements, and Sun Health Services retains the right to any excess assets that may exist upon termination of the Sun Health Pension Plan. Benefit accruals under the Sun Health Pension Plan have been frozen since May 2007, except for certain employees whose

11. Retirement Plans (continued)

salary benefits were not frozen until 2014. At December 31, 2014 and 2013, Banner recorded a non-current liability of $37,312,000 and $22,041,000, respectively, representing the unfunded liability under the Sun Health Pension Plan, and a long-term receivable from Sun Health Services in the same amount in the accompanying consolidated balance sheets.

The following table sets forth the benefit obligation and assets of the Sun Health Pension Plan at December 31 (using measurement dates as of December 31, 2014 and 2013, respectively):

	2014	2013
	(In Thousands)	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	**$ 92,984**	$ 104,029
Service cost	**100**	91
Interest cost	**4,492**	4,147
Actuarial loss (gain)	**19,520**	(11,438)
Benefits paid	**(7,848)**	(3,845)
Projected benefit obligation at end of year	**109,248**	92,984
Change in plan assets		
Fair value of plan assets at beginning of year	**70,943**	61,686
Actual return on plan assets	**1,281**	8,252
Employer contributions	**7,560**	4,850
Benefits paid	**(7,848)**	(3,845)
Fair value of plan assets at end of year	**71,936**	70,943
Funded status – accrued benefit recorded	**$ (37,312)**	$ (22,041)

The assumptions used to determine the projected benefit obligation include the weighted average discount rate of 4.08% and 4.91% as of December 31, 2014 and 2013, respectively, and weighted average expected long-term rate of return on plan assets of 7.00% as of December 31, 2014 and 2013.

11. Retirement Plans (continued)

The expected long-term rate of return on plan assets is based on historical and projected rates of return for current and planned asset categories in the Sun Health Pension Plan's investment portfolio. Assumed projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category using benchmark rates. Based on the target asset allocation among the asset categories, the overall expected rate of return for the portfolio was developed and adjusted for historical and expected experience of active portfolio management results compared to benchmark returns and for the effect of expenses paid from plan assets.

Banner's overall investment strategy with the Sun Health Pension Plan is to achieve a mix of approximately 60% of investments for long-term growth and 40% for near-term benefit payments with a wide diversification of asset types, fund strategies, and fund managers. The target allocations for plan assets are 50% equity securities, 30% fixed-income securities, and 20% alternative investments. Equity securities include U.S. and international investments and range from large-cap to small-cap companies. Fixed-income securities include corporate bonds of companies from diversified industries, mortgage-backed securities, and U.S. Treasuries. Alternative investments include mainly hedge funds that invest in several different strategies.

The fair value of Banner's Sun Health Pension Plan assets at December 31, 2014, by asset category, is as follows:

	December 31 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
	(In Thousands)				
Asset category					
Registered investment company funds:					
U.S. funds	**$ 24,598**	**$ 24,598**	**$ –**	$ –	**a**
International funds	**21,425**	**21,425**	**–**	–	**a**
Alternative investment	**14,678**	**–**	**–**	**14,678**	**a,c**
Common/collective trust funds	**11,235**	**–**	**11,235**	**–**	**a**
	$ 71,936	**$ 46,023**	**$ 11,235**	**$ 14,678**	

11. Retirement Plans (continued)

	December 31 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
	(In Thousands)				
Asset category					
Registered investment company funds:					
U.S. funds	$ 22,810	$ 22,810	$ –	$ –	a
International funds	21,676	21,676	–	–	a
Alternative investment	13,862	–	–	13,862	a,c
Common/collective trust funds	12,595	–	12,595	–	a
	$ 70,943	$ 44,486	$ 12,595	$ 13,862	

The table below summarizes the changes in fair value of the Plan's Level 3 assets for the year ended December 31, 2013 (in thousands):

Balance at January 1, 2013	$ 12,612
Net appreciation in fair value of investments	1,250
Balance at December 31, 2013	13,862
Net appreciation in fair value of investments	**816**
Balance at December 31, 2014	**$ 14,678**

Information about the expected cash flows for the Sun Health Pension Plan follows (in thousands):

Expected employer contributions in 2015	$ 4,800,000
Expected benefit payments:	
2015	4,480,000
2016	4,667,000
2017	4,986,000
2018	5,199,000
2019	5,464,000
2020–2024	30,722,000

11. Retirement Plans (continued)

Health and Dental Plan

Employees of Banner are provided health and dental coverage through a combination of several programs, purchased and self-insured. Health, dental, and group life coverage is funded through employee and employer contributions. Banner's health, dental, and group life insurance expense was $140,307,000 and $140,450,000 for the years ended December 31, 2014 and 2013, respectively.

Long-Term Disability Plan

Employees of Banner are provided long-term disability coverage through an external purchased insurance plan. Banner's long-term disability expense was $4,474,000 and $2,987,000 for the years ended December 31, 2014 and 2013, respectively.

Supplemental Executive Retirement Plan

Banner has a supplemental executive retirement plan for certain senior executive's retirement and death benefits. Banner's executive retirement plan expense was $8,510,000 and $3,740,000 for the years ended December 31, 2014 and 2013, respectively. The actuarially determined liability amounting to approximately $23,332,000 and $19,877,000 as of December 31, 2014 and 2013, respectively, has been discounted to present value using a discount rate of 3.86% in 2014 and 4.5% in 2013.

12. Income Taxes

Banner's deferred tax assets, primarily related to BHN and a for-profit physician clinic, consist of the following as of December 31:

	2014	2013
	(In Thousands)	
Deferred tax assets:		
Net loss carryforwards	**$ 19,572**	$ 21,037
Allowance for doubtful accounts	**296**	136
Accrued compensation	**251**	220
Unrealized gross receipts	**241**	–
Accrued expenses	**786**	878
Total deferred tax assets	**21,146**	22,271
Valuation allowance	**(21,146)**	(22,271)
Net deferred tax asset after valuation allowance	**$ –**	$ –

As of December 31, 2014, Banner has estimated federal net operating loss carryforwards of $49,594,000 that begin to expire in the year 2028 and estimated state net operating loss carryforwards of $49,551,000 that begin to expire in 2028. For financial reporting purposes, a valuation allowance of $21,146,000 and $22,271,000 at December 31, 2014 and 2013, respectively, has been established to offset deferred tax assets mainly relating to net operating losses. Pursuant to standards for accounting for income taxes, Banner has established a valuation allowance equal to the net deferred tax asset due to uncertainty as to whether the net deferred tax asset will be realized in future periods. As a result, Banner does not recognize any tax benefit until the taxable operating entities, primarily BHN, is in a tax-paying position and, therefore, more likely than not to realize the tax benefit.

12. Income Taxes (continued)

A reconciliation of Banner's income taxes computed at the federal statutory rate to the income tax benefit for the years ended December 31 consists of the following (in thousands):

	2014	2013
	(In Thousands)	
Computed tax (expense) benefit at 34%	**$ (1,713)**	$ 13,560
State taxes net of federal benefit	**1**	1,489
Change in valuation reserve	**1,125**	(15,049)
Change in tax rate	**218**	–
Other	**369**	–
	$ –	$ –

Banner has not recorded any expense or accrued for any related expense for any uncertain tax positions. Banner's 2008 through 2014 tax years remain subject to examination for federal income tax purposes, whereas the 2008 through 2014 tax years remain subject to examination for state taxing jurisdictions in which Banner operates.

13. Commitments and Contingencies

Leases

Future minimum lease payments (excluding operating agreements), by year and in the aggregate, under non-cancelable operating lease arrangements with initial or remaining terms of one year or more consist of the following at December 31, 2014 (in thousands):

2015	$ 22,991
2016	19,060
2017	13,687
2018	8,667
2019	6,469
Thereafter	16,981
	$ 87,855

Operating Agreements

North Colorado Medical Center

Prior to December 31, 2011, Banner subleased North Colorado Medical Center (NCMC) and other real and personal property comprising substantially all of the assets located in Weld County, Colorado, and used by Banner for health care operations from NCMC, Inc. pursuant to an Amended and Restated Operating Agreement (the First Amended Operating Agreement). Under the First Amended Operating Agreement, Banner was required to pay rent to NCMC, Inc. monthly in two components: (i) asset depreciation expense and (ii) return on assets. Asset depreciation expense was an amount equal to the total actual asset depreciation expense of NCMC, Inc., and return on assets was an amount equal to 8% of the year-end net book value of NCMC, Inc.'s assets. NCMC, Inc. was required to pay Banner $500,000 on a quarterly basis to compensate Banner for indigent care provided in the leased assets.

13. Commitments and Contingencies (continued)

Effective as of January 1, 2012, Banner entered into a Second Amended and Restated Operating Agreement (the Second Amended Operating Agreement) with NCMC, Inc. The Second Amended Operating Agreement extended the term of the lease through December 31, 2027. Under the Second Amended Operating Agreement, Banner is required to pay rent to NCMC, Inc. monthly for most assets under the same rent formula as provided in the First Amended Operating Agreement, with two exceptions: (i) rent for certain real existing and future property used for ancillary health care operations is based on a fair market value rent as negotiated by the parties, and (ii) the return on assets for approximately $60,000,000 of infrastructure improvements to be made by NCMC, Inc. to NCMC from 2012 to 2014 is 4% of the year-end net book value of such infrastructure improvements. The Second Amended Operating Agreement also requires Banner to approve additional annual capital expenditures averaging $16,000,000 over the term of the Second Amended Operating Agreement. Banner is also required to pay additional rent of $1,000,000 per year through 2017. To compensate for indigent care provided by Banner, NCMC, Inc. is required to pay Banner $3,000,000 in 2013, $4,000,000 in 2014, $5,000,000 in 2015, and $5,000,000 in each year thereafter, which has been and will be recorded as contribution revenue in the year earned. If, at the end of 2017, 2022, and 2027, the cumulative operating income from Banner's health care operations in Weld County exceeds 5% of the cumulative net operating revenue during the preceding five-year period, Banner will pay to NCMC, Inc. 50% of such excess. If cumulative operating income for the five-year period is less than zero, NCMC, Inc. will pay Banner 50% of the amount by which the operating income was less than zero, provided that the aggregate asset depreciation expense paid by Banner during such five-year period, less the charity payment made by NCMC, Inc., may not be less than the amount of the scheduled annual debt service made by NCMC, Inc. during such period. As of December 31, 2014, management has determined that it is probable that Banner will be paying an additional lease payment of approximately $7,000,000 in 2017 based on the projected five-year cumulative operating income for NCMC. Accordingly, management recorded the additional $7,000,000 lease payment as an increase to other long-term liabilities and a reduction to the lease obligation with NCMC, Inc. as of December 31, 2014.

13. Commitments and Contingencies (continued)

During 2012, NCMC, Inc. commenced the $60,000,000 infrastructure improvement construction project at NCMC. In accordance with the lease accounting standards, Banner is considered to have substantially all of the risks of ownership of NCMC during the construction period as Banner will continue to pay rent during the construction period. Accordingly, Banner has recorded an asset entitled Property leased from NCMC, Inc. and a corresponding obligation entitled Lease obligation with NCMC, Inc. of $205,951,000 in 2012 and an additional asset and corresponding obligation of $18,833,000 and $16,781,000 were recorded in 2014 and 2013, respectively. Once construction is complete, Banner will evaluate the recording of the NCMC asset and liability in accordance with the sale/leaseback accounting standards. The Property leased from NCMC, Inc. is being depreciated over the lease term and total depreciation expense recorded by Banner for the years ended December 31, 2014 and 2013, amounted to $20,370,000 and $18,687,000, respectively. Interest expense recorded by Banner on the Lease obligation with NCMC, Inc. amounted to $12,842,000 and $12,932,000 for the years ended December 31, 2014 and 2013, respectively.

Total payments made to NCMC, Inc. amounted to $31,863,000 and $32,040,000 for the years ended December 31, 2014 and 2013, respectively.

Greater Fairbanks Community Hospital

Banner leases from the Greater Fairbanks Community Hospital Foundation (the Foundation) a hospital facility, a skilled nursing facility, and a physician clinic located in Fairbanks, Alaska. The entities together are referred to as the Facility. The lease obligates Banner to operate the Facility and pay basic rent based on the fair market value per square foot for the Facility, adjusted annually. In exchange for rents to be paid, the lease obligates the Foundation to purchase all future equipment for the Facility. In addition to the basic rent, additional rent payments are required to be made by Banner to the Foundation based on excess cash flows, net of expenses, as defined. The net effect of the additional rent payments is that Banner retains the operating income from the Facility, up to 4.50% of the total revenue, and pays the balance of the operating income to the Foundation as additional rent. Rental expense under the Facility's operating lease totaled $27,840,000 and $33,158,000 for the years ended December 31, 2014 and 2013, respectively. In 2011, Banner and the Foundation extended the expiration of the stated term of the lease from January 1, 2013 to January 1, 2033. The lease can be terminated at any time without cause by either Banner or the Foundation with one year's notice.

13. Commitments and Contingencies (continued)

In 2015, the Foundation will commence a construction project at the Facility for a surgical building. In accordance with the lease accounting standards, Banner will be considered to have substantially all of the risks of ownership of the surgical building during the construction period as Banner will continue to pay rent during the construction period. Accordingly, Banner will be recording an asset and a corresponding obligation associated with the construction costs of the surgical building. The estimated value of the construction project is approximately $80,000,000.

Amounts charged to expense for all operating leases totaled $93,588,000 in 2014 and $101,623,000 in 2013.

Debt Guarantee

Banner has guaranteed payment of the principal and interest on various debt offerings of NCMC, Inc. pursuant to the limited guaranty agreements entered into with the bond trustee. Under the limited guaranty agreements applicable to the NCMC, Inc. Series 2013, 2012, 2003A, and 2003B bonds, Banner agrees to pay the principal and interest on such bonds in the event of default by NCMC, Inc.; however, the aggregate amount payable under the limited guaranty agreements applicable to the Series 2013, 2012, 2003A, and 2003B bonds is limited to the rent otherwise payable under the Second Amended Operating Agreement. As of December 31, 2014, $207,023,000 (unaudited) was outstanding under the NCMC, Inc. Series 2013, 2012, 2003A, and 2003B bonds, net of an amount held in escrow. The maximum annual debt service on the NCMC, Inc. Series 2013, 2012, 2003A, and 2003B bonds is approximately $19,296,000 (unaudited). In the event of default by NCMC, Inc., Banner has agreed to pay directly to the trustee, monthly, the portion of the rent equal to NCMC, Inc.'s debt service obligation. Such payments are to be credited against rent and all other payment obligations to NCMC, Inc. under the Second Amended Operating Agreement. Banner is not obligated to pay any amounts that become due on such bonds as a result of acceleration of the principal of the bonds under the Master Indenture. Banner's obligations under the limited guaranty agreements cease upon the termination of the Second Amended Operating Agreement. Banner did not record a liability for the limited guaranty agreements at December 31, 2014 or 2013.

In October 2004, Banner entered into a limited guarantee of the scheduled payments of principal and interest owed by the Foundation with respect to the $120,000,000 Revenue Bonds (the Bonds) issued simultaneously by the Alaska Industrial Development and Export Authority (the Authority), the proceeds of which were used to finance expansion and improvements of the Hospital. In 2009, Banner entered into three additional limited guarantees of the scheduled

13. Commitments and Contingencies (continued)

payments of principal and interest owed by the Foundation with respect to three series of revenue bonds in the aggregate initial principal amount of $90,630,000 (the 2009 Bonds), and in 2014, Banner entered into another limited guarantee of the scheduled payments of principal and interest owed by the Foundation with respect to revenue bonds in the aggregate initial principal amount of $51,275,000 (the 2014 Bonds, and together with the 2004 and the 2009 bonds, the Bonds). The limited guarantees are only in effect during the period that the lease for the Facility is in effect. If the lease is terminated by either Banner or the Foundation, the limited guarantee will cease to be effective. Moreover, Banner receives a credit against its rent obligation for any amount that it pays under the limited guarantee. The annual scheduled debt service for the Bonds is projected to be approximately $12,100,000 (unaudited), which is less than the basic rent currently owed under the lease, and substantially less than the sum of the basic rent and projected additional rent. Under certain circumstances, the annual scheduled debt service can be increased in accordance with an accelerated redemption of the Bonds. In those circumstances, the aggregate amount payable under the limited guarantees is expressly limited to the amount of the rent otherwise payable by Banner under the lease. Under any reasonably foreseeable circumstance, management believes that the aggregate amount payable under the limited guarantees will never exceed the rent otherwise payable under the lease. Therefore, Banner did not record a liability for the limited guarantee at December 31, 2014 and 2013.

Facility Construction

Banner is undertaking significant renovation and expansion projects at several of its facilities. The cost to complete construction and purchase equipment for these projects is estimated to be $106,000,000 (unaudited).

MD Anderson Cancer Center

Banner entered into an agreement with MD Anderson Physician Network (MD Anderson) to develop and operate a comprehensive cancer program consisting of inpatient beds and an outpatient cancer center that was constructed on the campus of Banner Gateway Medical Center, which opened in 2011. Under the terms of the agreement, Banner retains ownership of the cancer program and cancer center. MD Anderson provides clinical oversight and other program support services and is reimbursed for these services based on a fixed and variable fee schedule outlined in the agreement. Banner paid fees of approximately $6,106,000 and $5,664,000 to MD Anderson for the years ended December 31, 2014 and 2013, respectively.

13. Commitments and Contingencies (continued)

Compliance with Laws and Regulations

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers.

Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

Self-Disclosure of Potential Violations of the Stark Law

Through its compliance program, Banner has identified certain situations that raised potential issues with respect to compliance with the strict requirements of the Stark Law (42 U.S.C. §1395nn) and the corresponding regulations (42 CFR §411.351 et seq). The issues included missing signatures on agreements, operating under agreements after their stated expiration, and other technical issues. Banner's investigation showed little or no benefit to physicians and no inappropriate costs to any governmental entity as a result of these technical violations. Banner self-disclosed these issues to CMS in 2010, utilizing the Self-Referral Disclosure Protocol issued by CMS in September 2010. As required by the Self-Referral Disclosure Protocol, Banner informed CMS that the estimated value of the physician referrals potentially affected by the matters identified in the self-disclosure is approximately $21,000,000. CMS has not yet responded substantively to the self-disclosure. Because there is very little experience with CMS's settlement of matters disclosed by hospitals under the Self-Referral Disclosure Protocol, the ultimate outcome is difficult to estimate. However, management believes that it has adequately provided for the most likely outcome from the self-disclosure based on the information available at this time. Management intends to settle any such liability on the basis that the technical and inadvertent nature of the potential violations, the absence of any benefit to the physicians involved in the potential violations, the absence of any damage to any governmental health program, and the voluntary nature of the disclosure are significant mitigating factors that warrant reductions in the potential exposure.

13. Commitments and Contingencies (continued)

Medical Lien Settlement Litigation

Banner is a defendant in pending class action litigation (*Winters v. Banner Health*) challenging Banner's authority under state law to enforce health care provider liens authorized under Arizona law upon third-party recoveries that may be obtained by patients who receive treatment from Banner and who are covered under the Arizona Health Care Cost Containment System (AHCCCS). The lawsuit alleges that Banner's enforcement of health care provider liens to obtain payment in addition to that paid by AHCCCS is preempted by federal law governing Medicaid, and challenges both the continuing enforcement of such liens, and the lien collections obtained previously by Banner under documented settlements with patients covered by AHCCCS. While the trial court has granted summary judgment against Banner in the portion of the lawsuit pertaining to current collections, the court granted summary judgment in favor of Banner with respect to the plaintiffs' attempt to recover amounts previously collected by Banner under prior documented settlement agreements. However, in 2014, the Arizona Court of Appeals reversed the trial court's summary judgment with respect to the plaintiffs' attempt to recover amounts previously collected by Banner, holding that plaintiffs' could recover such amounts. The decision of the Court of Appeals has been appealed to the Arizona Supreme Court. If the Court of Appeals' ruling is upheld by the Arizona Supreme Court, the matter will be remanded to superior court, where a number of open issues will be addressed that would affect the amount of the liability, including the period of limitations and the amount of pre-judgment interest. Depending upon the outcome of the litigation over these issues, it is difficult to estimate the range of potential liability, but it is anticipated that the liability could exceed $5,000,000. Management believes it has adequately provided for the most likely outcome from the medical lien litigation based on information available at this time.

Emergency Physician Insurance Program.

Banner Indemnity, Limited ("BIL"), a wholly owned subsidiary of Banner, is the insurer for the Emergency Physician's Insurance Program (the "EPIP"), an insurance program that was established in 2003 to provide occurrence professional liability insurance for independent emergency physicians who are members of three physician groups that provide emergency department coverage at various Banner hospitals. Under the EPIP, BIL collects premiums from the physician groups which fund a separate risk pool from which BIL pays the costs of defense and losses on claims. The premiums are established based upon actuarial estimates provided by an independent actuarial firm. During the early years of the program, the actuarial estimates of the amounts necessary to establish the appropriate reserves were based primarily upon industry experience. More recently, the premiums for the EPIP have been based in part upon industry

13. Commitments and Contingencies (continued)

experience and in part upon the actual loss experience of the EPIP. As a result of relatively favorable loss experience, the EPIP assets currently exceed its currently projected liabilities. The physician groups that participate in the EPIP have asserted that they are entitled to receive payment of any excess funding of the EPIP, which they allege to be at least $9,000,000. At this time, it is not clear what theory of recovery would be advanced as the physician groups are not shareholders in BIL and there is no provision in any of the EPIP insurance policies issued by BIL for any return of premium or other rebate or distribution to the physician groups. It is also unclear as to how the amount of any such "excess" would be determined taking into account the extended period of exposure for claims against the EPIP and the uncertainty of future performance of the EPIP. Management is continuing to evaluate the merits of any potential claim. As a result, it is not possible to assess the likelihood of an unfavorable outcome if a specific claim were to be asserted or to estimate the range of potential liability in the event of an unfavorable outcome.

In addition to general and professional liability claims, Banner is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters are expected to be resolved without material adverse effect on Banner's consolidated financial position, results of operations, or cash flows.

14. Subsequent Events

University of Arizona Health Network/University of Arizona Colleges of Medicine Affiliation

On February 28, 2015, Banner, University of Arizona Health Network (UAHN), and the University of Arizona (UA) entered into a strategic affiliation through the merger of UAHN and its wholly owned subsidiary, University Medical Center Corporation (UMCC), into Banner, and the execution by Banner and UA of a 30-year academic affiliation agreement (the AAA) providing for ongoing support of the UA Colleges of Medicine in Tucson and Phoenix, and for Banner Good Samaritan to become the primary teaching affiliate of the UA College of Medicine – Phoenix. Under the transaction, Banner acquired The University of Arizona Medical Center (the Medical Center), a 467-licensed bed tertiary hospital and the primary academic teaching affiliate of the UA College of Medicine – Tucson, the faculty practice plan known as University Physicians Healthcare, which includes approximately 610 physicians (UPH), the health plans owned by UAHN and UPH which cover approximately 130,000 lives, nearly all of whom are covered by a health plan contracted with the AHCCCS, and all other subsidiary

14. Subsequent Events (continued)

organizations of UAHN. Banner also assumed the lease agreement between UPH and Pima County, Arizona, for the South Campus of The University of Arizona Medical Center, a 245-licensed bed hospital in Tucson, Arizona (the South Campus). Banner also acquired from the Arizona Board of Regents, by long-term ground lease, the real estate underlying the Medical Center (which is currently ground-leased to UMCC) plus additional land necessary for the expansion and renovation of the Medical Center for $59,000,000.

In connection with the merger and affiliation, Banner paid approximately $677,811,000 to UAHN, which payment, together with available UAHN cash and investments, was used by UAHN to: (i) defease all of the long-term indebtedness of UAHN and its subsidiaries, totaling approximately $360,000,000, (ii) pay certain outstanding liabilities of UAHN to UA; and (iii) contribute $261,000,000 to an Academic Enhancement Fund held by a trust established by UA (which will contribute $39,000,000 to the Academic Enhancement Fund, for a total of $300,000,000), which will provide $20,000,000 of annual support for academic enhancements, faculty recruitment and program development at the UA College of Medicine – Tucson and College of Medicine – Phoenix. In addition, Banner has agreed to (i) fund such additional amounts as may be needed to meet the $20,000,000 annual commitment during the 30-year term of the AAA to the extent that the Academic Enhancement Fund, and earnings thereon, is insufficient to do so; (ii) expend (or incur a binding commitment to expend) at least $500,000,000 within five years of closing of the affiliation on capital projects in Tucson to support the clinical enterprise, including the expansion and renovation of the Medical Center and construction of a new multi-specialty outpatient clinic and ambulatory surgery center on a site north of the Medical Center; and (iii) subject to certain adjustments, fund annual amounts for funds flow and mission support in (A) a minimum amount of $151,300,000, plus (B) 0.4% of the net operating revenue of the Medical Center, the South Campus, Banner Good Samaritan and UPH, plus (C) a variable amount equal to one-half of the combined operating income of the Medical Center, the South Campus, Banner Good Samaritan, and UPH in excess of a 5% operating margin.

Management is currently in the process of obtaining an external valuation of the UAHN assets acquired and liabilities assumed which will be used to determine the purchase price allocation to be recorded in Banner's 2015 financial statements.

14. Subsequent Events (continued)

Investment in Cenpatico of Arizona, Inc.

University Health Plans (UHP), a subsidiary of University of Arizona Health Network, is a collaborator with Cenpatico of Arizona, Inc., which was awarded the contract for the Regional Behavioral Health Authority for all of central and southern Arizona, excluding Maricopa County. UHP has entered into a commitment to purchase 20% of Cenpatico of Arizona and to guarantee its pro rata share of 300% of Cenpatico's statutorily mandated capital. At this time, this commitment is estimated to total approximately $20,000,000 to be funded no later than September 2015.

Mizuho Bank, Ltd. Loan

In order to finance its payment obligations with respect to the UAHN merger, Banner entered into a $700,000,000 taxable loan ("interim loan") with Mizuho Bank, Ltd., acting through its New York branch. The interim loan matures on February 25, 2016, and will bear interest at a variable rate based on LIBOR.

The interim loan is governed by a Master Indenture covering substantially all of Banner's indebtedness and obligations under swap agreements.

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