Consolidated Financial Statements

Banner Health and Subsidiaries
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Banner Health and Subsidiaries

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Years Ended December 31, 2016 and 2015

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, 2016 and 2015, 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, 2016 and 2015, 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 20, 2017

Banner Health and Subsidiaries

Consolidated Balance Sheets

	December 31 2016	December 31 2015
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 100,417**	$ 91,983
Short-term investments	**217,579**	280,730
Collateral held under securities lending program and repurchase agreements	**354,044**	253,538
Assets limited as to use	**124,927**	113,631
Patient receivables, net of allowance for doubtful accounts of $191,512 and $200,853 in 2016 and 2015, respectively	**792,372**	769,564
Inventories	**189,414**	186,381
Other receivables	**260,464**	163,585
Other, primarily prepaid expenses	**74,453**	74,267
Total current assets	**2,113,670**	1,933,679
Assets limited as to use:		
Funds designated by:		
Board of Directors	**1,814,987**	1,709,994
Lease agreements	**2,998**	3,405
Funds held by trustees under:		
Self-insurance funding arrangements	**132,511**	169,555
Other funds	**186,890**	208,829
Total assets limited as to use, less current portion	**2,137,386**	2,091,783
Assets held for sale	**2,140**	2,140
Property and equipment, net	**3,223,479**	3,106,031
Leased hospital assets	**300,471**	244,608
Other assets:		
Long-term investments	**2,070,757**	2,154,110
Other	**627,241**	541,464
Total other assets	**2,697,998**	2,695,574
Total assets	**$ 10,475,144**	$ 10,073,815

	December 31 2016	December 31 2015
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Trade accounts payable	**$ 240,938**	$ 172,790
Current portion of long-term debt	**155,949**	353,722
Current portion of hospital lease obligation	**23,785**	29,632
Payable under securities lending program and repurchase agreements	**354,044**	253,538
Estimated current portion of third-party payor settlements	**1,935**	14,609
Accrued expenses:		
Salaries and benefits	**422,676**	342,078
Medical claims payable	**99,280**	116,112
Other	**288,806**	252,730
Total current liabilities	**1,587,413**	1,535,211
Long-term debt, less current portion	**2,794,910**	2,800,532
Hospital lease obligation	**290,181**	216,051
Estimated self-insurance liabilities, less current portion	**169,901**	165,553
Estimated third-party payor settlements, less current portion	**28,922**	12,869
Interest rate swaps	**332,838**	361,031
Other	**214,499**	235,372
Total liabilities	**5,418,664**	5,326,619
Net assets:		
Unrestricted	**4,847,452**	4,573,296
Temporarily restricted	**178,444**	142,817
Total Banner Health net assets	**5,025,896**	4,716,113
Non-controlling interests – unrestricted	**30,584**	31,083
Total net assets	**5,056,480**	4,747,196
Total liabilities and net assets	**$ 10,475,144**	$ 10,073,815

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Income

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Revenues:		
Net patient service	**$ 6,465,309**	$ 5,973,945
Provision for doubtful accounts	**290,661**	294,720
Net patient service revenue, less provision for doubtful accounts	**6,174,648**	5,679,225
Medical insurance premiums	**1,081,124**	986,430
Other revenue	**377,433**	305,477
Total other operating revenue	**1,458,557**	1,291,907
Total revenues	**7,633,205**	6,971,132
Expenses:		
Salaries and benefits	**3,716,655**	3,387,128
Supplies	**1,263,295**	1,132,555
Physician and professional fees	**173,440**	154,599
Medical claims cost, net of Banner claims of $405,122 and and $340,173 in 2016 and 2015, respectively	**743,978**	650,941
Depreciation and amortization	**404,083**	383,999
Goodwill impairment	**20,722**	–
Interest	**139,043**	165,277
Other	**1,014,935**	968,251
Total expenses	**7,476,151**	6,842,750
Operating income	**157,054**	128,382
Other income (loss):		
Investment income – realized	**66,073**	146,390
Investment gain (loss) – unrealized	**60,893**	(131,577)
Income (loss) from alternative investments	**39,450**	(24,771)
Investment income (loss)	**166,416**	(9,958)
Unrealized gain (loss) on interest rate swaps	**27,965**	(4,651)
Loss on extinguishment of debt	**(51,634)**	(727)
Other	**(3,059)**	(8,491)
	139,688	(23,827)
Excess of revenues over expenses	**296,742**	104,555
Less excess of revenues over expenses attributable to non-controlling interest	**27,919**	20,850
Excess of revenues over expenses attributable to Banner Health	**268,823**	83,705
Amortization of cumulative loss on interest rate swaps	**227**	227
Decrease in unfunded pension liability	**391**	768
Contributions for property and equipment acquisitions	**4,715**	12,645
Increase in unrestricted net assets	**$ 274,156**	$ 97,345

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Changes in Net Assets

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Unrestricted net assets:		
Excess of revenues over expenses	**$ 268,823**	$ 83,705
Amortization of cumulative loss on interest rate swaps	**227**	227
Decrease in unfunded pension liability	**391**	768
Contributions for property and equipment acquisitions	**4,715**	12,645
Increase in unrestricted net assets	**274,156**	97,345
Temporarily restricted net assets:		
Contributions	**51,993**	46,466
Net unrealized gain (loss) on investments	**728**	(928)
Net assets released from restrictions for property and equipment additions	**(4,691)**	(12,401)
Net assets released from restrictions for operations	**(12,403)**	(18,013)
Increase in temporarily restricted net assets	**35,627**	15,124
Non-controlling interests:		
Excess of revenue over expenses attributable to non-controlling interests	**27,919**	20,850
Other changes, primarily distributions of earnings to non-controlling interests	**(28,418)**	(14,292)
(Decrease) increase in non-controlling interests	**(499)**	6,558
Increase in net assets	**309,284**	119,027
Net assets, beginning of year	**4,747,196**	4,628,169
Net assets, end of year	**$ 5,056,480**	$ 4,747,196

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Operating activities		
Increase in net assets	**$ 309,284**	$ 119,027
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	**404,083**	383,999
Goodwill impairment	**20,722**	–
Increase in investments designated as trading	**89,605**	(207,111)
Net unrealized (gain) loss on interest rate swaps	**(28,192)**	4,424
Decrease in unfunded pension liability	**(391)**	(768)
Loss on extinguishment of debt	**51,634**	727
Gain on sale of assets, net	**(265)**	(350)
Contributions for purchase of property and equipment and other	**(4,715)**	(12,645)
Temporarily restricted contributions	**(51,993)**	(46,466)
Changes in operating elements, net of acquisitions and dispositions:		
Patient receivables	**(22,756)**	(51,579)
Inventories and other current assets	**(98,360)**	(64,180)
Accounts payable and accrued expenses	**162,510**	49,287
Estimated third-party payor settlements	**3,379**	2,026
Estimated self-insurance liabilities	**4,348**	36,372
Other liabilities	**(20,275)**	18,639
Net cash provided by operating activities	**818,618**	231,402
Investing activities		
Net purchases of property and equipment	**(477,760)**	(349,848)
Decrease in funds held under indenture agreements	**–**	57,485
Acquisitions, primarily University of Arizona Health Network, net of cash acquired of $947 in 2016 and $128,634 in 2015	**(73,730)**	(610,149)
Increase in other assets	**(40,334)**	(998)
Net cash used in investing activities	**(591,824)**	(903,510)
Financing activities		
Proceeds from temporarily restricted contributions	**51,993**	46,466
Proceeds from issuance of debt	**925,328**	1,466,178
Payments of hospital lease obligations	**(15,324)**	(17,121)
Payments of long-term debt	**(1,180,357)**	(838,661)
Net cash (used in) provided by financing activities	**(218,360)**	656,862
Net increase (decrease) in cash and cash equivalents	**8,434**	(15,246)
Cash and cash equivalents at beginning of year	**91,983**	107,229
Cash and cash equivalents at end of year	**$ 100,417**	$ 91,983
Supplemental disclosure of cash flow information		
Interest paid, including amounts capitalized	**$ 167,132**	$ 174,099
Non-cash activities		
Decrease in receivable from Sun Health and related obligation for retirement plan	**$ (1,111)**	$ (2,311)
Capital lease obligation	**$ 83,848**	$ 83,351

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, control, or lease hospitals, clinics, nursing homes, clinical laboratories, ambulatory surgery centers, urgent care centers, home health agencies, a captive insurance company, a foundation, an accountable health care organization (see Note 6), a Medicaid managed care health plan and related Medicare Advantage health plan, 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, 2016 and 2015.

- A 50% non-controlling interest in Veritage LLC (Veritage) that 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's net income has been recorded within operating revenue for the years ended December 31, 2016 and 2015.

Banner Health and Aetna Health Insurance Holding Company LLC

In October, 2016, Banner entered into an agreement with Aetna ACO Holdings, Inc. (Aetna), a subsidiary of Aetna, Inc., pursuant to which Banner and Aetna agreed to form an insurance holding company, Banner Health and Aetna Health Insurance Holding Company LLC (HoldCo), to be owned 49% by Banner and 51% by Aetna, to be the parent of two Arizona insurance companies (collectively, NewCo). The agreement provides for NewCo to become licensed as Arizona insurance companies in 2017, and to begin issuing insurance policies in 2018. In addition, commencing upon the licensure of NewCo as an insurance company in 2017, NewCo expects to assume risk prospectively through reinsurance arrangements, and plans to share in profits and losses retroactively to January 1, 2017 through a contractual arrangement, for certain insurance arrangements, and self-insurance administrator activities conducted by Aetna or its affiliates in the Phoenix metropolitan area. Banner, through its subsidiary Banner Plan Administration, Inc., and Aetna, through certain affiliates, will provide various administrative services to NewCo, and Banner.

1. Description of Business (continued)

Under the agreement, Banner is obligated to contribute capital to HoldCo during 2017 of approximately $85 million, subject to adjustment based on a number of factors including the successful renewal of existing Aetna insurance and self-insurance administrator business in Arizona or the migration of such business into NewCo. Thereafter, Banner may be required to make additional capital contributions in part based upon the successful renewal or migration of existing Aetna business within the scope of the joint venture, as well as may be necessary in order to fund adequate working capital for NewCo and HoldCo, and to maintain the total adjusted capital of NewCo at 550% of NewCo's National Association of Insurance Commissioners authorized Control Level Risk Based Capital.

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 business ventures; the business venture financial results are included within Banner's consolidated financial statements. Banner records the unrelated investor's ownership share of these business ventures as non-controlling interest. The non-controlling interest balance as of December 31, 2016 and 2015, primarily relates to the minority interest owner's investment in SQL.

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

Subsequent Events

Subsequent events have been evaluated through March 20, 2017, the date of issuance of the accompanying 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 (continued)

Acquisition of Urgent Care Centers

On November 1, 2016, Banner acquired all of the assets of Arizona urgent care centers operated by UCXtra Umbrella, LLC and UCXtra Services, LLC, under the name "Urgent Care Extra" (UCE). Under the terms of the transaction, Banner acquired 32 urgent care centers operating in the Phoenix and Tucson metropolitan areas, as well as 12 centers under development, expected to open in 2017. The base purchase price of approximately $62,654,000 was paid at closing. An additional "Earn-Out Purchase Price" up to $37,000,000 will be due if certain revenue targets are achieved during the "Earn-Out Determination Period", January 1, 2017 – December 31, 2019. Management has estimated that the revenue targets will not be met and no amounts have been recognized. Banner has recorded the purchase at the base purchase price.

Banner recorded the purchase price as follows (in thousands):

Inventory and other current assets	$ 650
Property and equipment	5,469
Goodwill	56,535
Net assets acquired	$ 62,654

Acquisition of HCP AZ LLC

On June 1, 2016, Banner acquired Health Care Partnership Arizona, LLC (HCP AZ LLC) and Healthcare Partners Arizona Medical Group, LLC, which held membership interests in Arizona Integrated Physicians, Inc. (AIP) and operated two small medical clinics. Banner paid approximately $12,024,000, and agreed to pay up to an additional $3,000,000 on June 1, 2017 if certain conditions are met, including maintenance of insured patient membership attributed to physicians in the AIP network and the number of physicians in the AIP network. AIP sustained significant financial losses, and the legal entity HCP AZ LLC was merged into a new entity, Neighborhood Physician Alliance, LLC. on January 1, 2017. The medical clinics were closed in December, 2016. All of the goodwill, amounting to $14,621,000, associated with the HCP AZ LLC acquisition was written off in December 2016, as it was considered impaired due to the combination of operating losses and the dissolution of the legal entities HCP AZ LLC and Healthcare Partners Arizona Medical Group, LLC.

2. Significant Accounting Policies (continued)

Acquisition of University of Arizona Health Network

On February 28, 2015, the University of Arizona Health Network (UAHN) and its wholly owned subsidiary University Medical Center Corporation were acquired by Banner, and the purchase was accounted for as an acquisition in accordance with the not-for-profit business combination accounting standards. Under the transaction, Banner acquired a hospital in Tucson (now known as Banner – University Medical Center Tucson (B-UMCT)), a faculty practice plan, a Medicaid managed care health plan, and a related Medicare Advantage health plan, and assumed the lease of a second Tucson hospital (now known as Banner – University Medical Center South (B-UMCS)). In addition, Banner prepaid $59,000,000 to the Arizona Board of Regents for a 99-year ground lease associated with B-UMCT (included in the total purchase price consideration), which was initially recorded in other non-current assets. The ground lease included a purchase option whereby Banner could purchase the land for an additional $1,000,000 upon completion of certain zoning requirements set forth in the ground lease agreement. During 2016, the rezoning was completed and Banner acquired the land, which was appraised at approximately $20,000,000. The ground lease payment, together with the land cost and transaction fees paid in 2016, were recorded as property of $20,000,000 and goodwill of $41,249,000.

As part of the transaction, Banner and the University of Arizona (UA) executed 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 Medical Center (renamed Banner – University Medical Center Phoenix (B-UMCP)) (to become the primary teaching affiliate of the UA College of Medicine – Phoenix. Under the terms of the transaction, Banner contributed $261,000,000 (included within the total purchase price consideration) and UA contributed $39,000,000 to an Academic Enhancement Fund trust to 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 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 on capital projects in Tucson to support the clinical enterprise, including the expansion and renovation of B-UMCT and construction of a new multi-specialty outpatient clinic and ambulatory surgery center on a site north of B-UMCT; 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 B-UMCT, B-UMCS, B-UMCP, and the faculty practice plan, plus (C) a variable amount equal to one-half of the combined

2. Significant Accounting Policies (continued)

Acquisition of University of Arizona Health Network (continued)

operating income of B-UMCT, B-UMCS, B-UMCP, and the faculty practice plan in excess of a 5% operating margin. The annual funds flow commitment is subject to adjustment based upon fluctuations in governmental funding for graduate medical education. Banner funded $212,720,000 and $160,200,000 relating to the AAA funds flow and mission support for the years ended December 31, 2016 and 2015, respectively.

The purchase price of approximately $677,811,000 was allocated to the net tangible assets acquired, based upon their estimated fair values as of February 28, 2015. Results of the former UAHN operations have been included in Banner's consolidated financial statements since February 28, 2015. The fair values assigned to assets acquired and liabilities assumed were as follows (in thousands):

Current assets, including $128,631 in cash received	$ 342,056
Property and equipment	350,293
Other assets	216,048
Current liabilities	(191,953)
Non-current liabilities	(24,564)
Restricted equity for donor-restricted assets	(14,069)
Net assets acquired	$ 677,811

Included in the purchase price allocation above is approximately $22,900,000 of identifiable intangible assets and $69,696,000 of goodwill. The $22,900,000 of identifiable intangible assets primarily relates to the health insurance plans' existing membership assumed with the UAHN transaction and is being amortized over periods ranging from five to seven years. Banner has also recorded goodwill of approximately $69,696,000 relating to the difference between the estimated fair value of net assets assumed and the purchase price. An additional $41,249,000 was added to goodwill in 2016 related to completion of the land purchase.

Approximately $1,218,348,000 and $(25,210,000) in revenue and net loss, respectively, of the acquired UAHN entities has been included on the consolidated statements of income for the period from the acquisition date of February 28, 2015 through December 31, 2015. In 2015, Banner recorded operating expenses of approximately $16,324,000 related to the UAHN acquisition.

2. Significant Accounting Policies (continued)

Acquisition of Payson Regional Medical Center

On June 26, 2015, Mogollon Health Alliance, Inc., which owned the land and buildings comprising Payson Regional Medical Center (Payson), was acquired by Banner Health, which was accounted for as a business acquisition in accordance with the not-for-profit business combination accounting standards. The 44-bed hospital in Payson, Arizona, was operated by a subsidiary of Community Health Systems, Inc. (CHS) under a lease agreement that expired on July 31, 2015. Under the transaction, Banner acquired land and hospital buildings from Mogollon Health Alliance, Inc.; made a $40,000,000 contribution to MHA Foundation, a newly formed nonprofit corporation; and committed to make future health care capital expenditures in the Payson area of at least $25,000,000 over the next seven years. Upon expiration of the CHS lease on July 31, 2015, Banner purchased from the CHS subsidiary the fixed assets used in operating the Payson hospital, physician clinics, and a home health agency for $11,372,000, and Banner purchased from the CHS subsidiary working capital consisting of accounts receivable, inventory, and other current assets for $9,600,000. Banner assumed complete ownership and control of the hospital, clinics, and home health agency on August 1, 2015. The fair values assigned to the assets acquired were as follows (in thousands):

Current assets, including $3 in cash acquired	$ 9,600
Property and equipment	40,815
Other assets	10,557
Assets acquired	$ 60,972

Included in the purchase price allocation above is approximately $10,557,000 of goodwill.

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.

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.

2. Significant Accounting Policies (continued)

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 that 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.

Banner invests in alternative investments, mainly hedge funds, through limited partnerships. As of December 31, 2016 and 2015, Banner has recorded approximately $1,316,746,000 and $1,393,565,000, 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

2. Significant Accounting Policies (continued)

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 $39,450,000 and ($24,771,000) of alternative investment unrestricted realized and unrealized gain (loss) for the years ended December 31, 2016 and 2015, respectively. The restricted share of alternative investment realized and unrealized income is approximately $1,109,000 and $444,000 for the years ended December 31, 2016 and 2015, respectively. As of December 31, 2016, approximately $6,839,000 of alternative investments was subject to a one-year redemption lockup period, and approximately $91,642,000 was subject to a two-year redemption lockup period. In addition, certain of Banner's alternative investment agreements follow a capital call structure, of which Banner has committed up to $177,500,000. Of that total, Banner has made capital contributions of $86,607,000 as of December 31, 2016, resulting in up to $90,893,000 in uncalled commitments.

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, 2016 and 2015. As of December 31, 2016, the gross derivative assets and liabilities held and netted together within the investment accounts amounted to assets of approximately $638,069,000 and liabilities of approximately $624,109,000. As of December 31, 2015, the gross derivative assets and liabilities held and netted together within the investment accounts amounted to assets of approximately $464,082,000 and liabilities of approximately $466,904,000 (see Note 4).

Banner has entered into several repurchase agreements amounting to approximately $95,412,000 and $10,800,000 as of December 31, 2016 and 2015, 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 $98,033,000 and $10,913,000 as of December 31, 2016 and 2015, respectively.

2. Significant Accounting Policies (continued)

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 the securities 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 on the accompanying consolidated balance sheets. At December 31, 2016 and 2015, the fair value of the collateral provided on behalf of Banner was approximately $256,011,000 and $242,625,000, respectively. At December 31, 2016 and 2015, the fair market value of securities on loan was approximately $248,081,000 and $235,254,000, respectively, and is included in assets limited as to use on the accompanying consolidated balance sheets.

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 services based on an entity-wide assessment, and as part of this assessment has determined that management does not assess the patient's ability to pay for the majority of self-pay patients. Accordingly, any patient account write-off is recorded within

2. Significant Accounting Policies (continued)

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.

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.

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 recognized an impairment of $442,000 in 2016 and $1,553,000 in 2015 for software whose use was discontinued.

Goodwill

Purchases of acquired businesses are allocated to the assets and liabilities assumed 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 is allocated to goodwill.

2. Significant Accounting Policies (continued)

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, 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 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 2015. In the fourth quarter of 2016, Banner completed a quantitative goodwill impairment analysis and recorded a goodwill impairment charge of $20,722,000.

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.

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.

2. Significant Accounting Policies (continued)

In December, 2016, Banner and Sun Health Services entered into an Amended and Restated Support and Maintenance Agreement. As part of that Agreement, the 2008 Sun Health Services commitment to future capital and program funding was reduced, and Sun Health Services agreed to pay Banner $60,000,000 as a Grant Buy-Down, to be used in support of its programs, services, and facilities in Maricopa County. Sun Health Services transferred $40,000,000 to Banner in December, 2016, and has committed to remit the remaining $20,000,000 by June 30, 2017, which is recorded in other current receivables as of December 31, 2016. Banner recorded the $60,000,000 grant as other income in 2016.

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, contributions for property and equipment acquisitions, and changes to unfunded pension liability.

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, other than potential credit risk associated with certain health insurance exchange plans that ceased operations as of December 31, 2015. Banner recorded an additional bad debt allowance of $7,987,000 as of December 31, 2015, relating to the uncollectibility of these receivables. A summary of the payment arrangements with major third-party payors follows.

2. Significant Accounting Policies (continued)

Medicare

Approximately 23.1% and 23.0% in 2016 and 2015, respectively 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 report have been audited and settled with the Medicare fiscal intermediary through December 31, 2012. The estimated settlement for Medicare cost report years 2013 through 2016 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.

Medicaid

Approximately 14.7% and 12.9% in 2016 and 2015, 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, or 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 & Medicaid Services (CMS) approved direct and indirect graduate medical education payments to Banner pursuant to a Medicaid state plan amendment submitted by the Arizona Health Care Cost Containment System (AHCCCS). In connection with this plan amendment, Banner recorded approximately $97,761,000 and $51,038,000 in 2016 and 2015, respectively, which has been recorded as an increase to net patient service revenue.

2. Significant Accounting Policies (continued)

Effective in 2014, AHCCCS, Arizona's version of Medicaid, was expanded to cover individuals with incomes up to 133% of the federal poverty level. In order to fund Arizona's share of the cost of this expansion, 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 years ended December 31, 2016 and 2015, Banner paid approximately $93,300,000 and $91,775,000, respectively, in AHCCCS hospital assessment fees, which 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 59.7% and 60.8% in 2016 and 2015, respectively, of Banner's net patient service revenue was derived from other third-party payors.

Self-Pay

Approximately 2.5% and 3.3% in 2016 and 2015, respectively, 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 who 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.

Medical Insurance Premiums and Medical Claim Costs

Banner Health Network (BHN) has entered into contracts with insurance companies whereby BHN receives a monthly capitation or percent-of-premium payment, and is responsible for the payment of the enrolled members' claims. For the years ended December 31, 2016 and 2015, BHN recorded premium revenue from insurance companies and CMS of approximately $542,134,000 and $545,019,000, respectively. BHN paid health care claims for services rendered to enrolled members of approximately $634,238,000 and $591,452,000 as of December 31, 2016 and 2015, respectively.

2. Significant Accounting Policies (continued)

The University of Arizona Health Plans, including University Care Advantage, University Family Care and University Health Marketplace (collectively, the University Health Plans), were acquired by Banner in 2015 as part of the acquisition of UAHN. University Health Marketplace ceased operations on December 31, 2015. The University Health Plans have entered into contracts with AHCCCS and CMS to provide health insurance services for enrolled members. Included in medical insurance premium revenue for 2016 and 2015 is \$538,990,000 and \$441,411,000, respectively, for the University Health Plans. Medical claims costs for 2016 and 2015 are \$514,862,000 and \$399,662,000, respectively.

The medical claims costs of BHN, the University Health Plans, and other plans owned by Banner Health reported on the consolidated statements of income are net of intercompany eliminations for services rendered at Banner facilities and providers. Medical claim costs are as follows (in thousands):

	Year Ended December 31 2016	2015
Net premium revenue	**$ 1,081,124**	$ 986,430
Net claims cost	**743,978**	650,941
Owned health plans elimination	**405,122**	340,173
Gross claims cost, including claims paid to Banner facilities and providers	**$ 1,149,100**	$ 991,114
Claims cost percentage of premium	**106.3%**	100.5%

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 \$17,126,000 and \$16,566,000 of Medicare and Medicaid incentive payments was recognized in other revenue for the years ended December 31, 2016 and

2. Significant Accounting Policies (continued)

2015, 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.

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 2016 and 2015, 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 $632,767,000 and $566,627,000, 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.

2. Significant Accounting Policies (continued)

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

	2016	% of Total Expense	2015	% of Total Expense
	(In Thousands)		*(In Thousands)*	
Traditional charity care, at cost	**$ 64,366**	**0.9%**	$ 62,875	0.9%
Unpaid cost of public programs, Medicaid, and other indigent care programs	**485,204**	**6.5**	410,355	6.0
Health professional education	**35,134**	**0.5**	45,796	0.7
Community health services	**7,453**	**0.1**	7,846	0.1
Research activities	**11,512**	**0.2**	11,855	0.2
Community-building activities	**853**	**–**	1,186	–
Subsidized health services	**24,470**	**0.3**	21,968	0.3
Contributions and in-kind donations	**3,679**	**–**	4,632	0.1
Community benefit operations	**96**	**–**	114	–
Total cost of community benefit	**632,767**	**8.5**	566,627	8.3
Unpaid cost of Medicare	**120,704**	**1.6**	178,982	2.6
Total cost of community benefit and unpaid cost of Medicare	**$ 753,471**	**10.1%**	$ 745,609	10.9%

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.

Unpaid Cost 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.

2. Significant Accounting Policies (continued)

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.

For the years ended December 31, 2016 and 2015, the provision for doubtful accounts decreased by approximately $38,000,000 and $39,000,000, respectively, for outside collection recoveries on patient receivables previously written off. Net patient service revenue increased in 2016 and 2015 by approximately $24,600,000 and $23,700,000, respectively, for changes in estimates related to

2. Significant Accounting Policies (continued)

third-party payor settlements. Revenue increased in 2016 and 2015 by approximately $25,000,000 and $22,000,000, respectively, for certain BHN contract settlements (see Note 6) and by approximately $19,300,000 in 2016 relating to additional share medical education reimbursement. Other expense decreased by $27,000,000 and $23,800,000 in 2016 and 2015, respectively, related to professional and general liability favorable claim experience.

New Accounting Pronouncements Adopted

In April 2015, the Financial Accounting Standards Board (FASB) issued a new accounting standard relating to the presentation of debt issuance costs. The new standard requires all debt issuance costs to be reported on the consolidated balance sheet as a direct reduction to the debt obligation. The accounting standard was effective for Banner on January 1, 2016. Debt issue costs were reclassified from other assets to long-term debt obligations in the accompanying balance sheets.

In May 2015, the FASB issued a new accounting standard relating to fair value measurement disclosures for investments in entities that are recorded based on the net asset value per share practical expedient. The new accounting standard eliminates the requirement to disclose this type of investment within the fair value hierarchy table. The accounting standard was effective for Banner on January 1, 2016, and primarily impacts the pension asset disclosures.

Pending Accounting Pronouncements

In May 2014, the FASB issued a new revenue accounting standard, together along with subsequent amendments, updates and an extension of the effective date, (collectively the "New Revenue Standard"), which supersedes most existing revenue recognition guidance, including industry-specific healthcare guidance. The New Revenue Standard provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

2. Significant Accounting Policies (continued)

This five-step process will require significant management judgment in addition to changing the way many companies recognize revenue in their financial statements. Additionally, and among other provisions, the New Revenue Standard requires expanded quantitative and qualitative disclosures, including disclosure about the nature, amount, timing and uncertainty of revenue.

The provisions of the New Revenue Standard are effective for annual periods beginning after December 15, 2017, including interim periods within those years by applying either the full retrospective method or the cumulative catch-up transition method. The full retrospective method requires application of the provisions of the New Revenue Standard for all periods presented while the cumulative catch-up transition method requires the application of the provisions of the New Revenue Standard as of the date of adoption with the cumulative effect of the retrospective application of the provisions as an adjustment through retained earnings. Currently, Banner anticipates adopting the provisions of the New Revenue Standard using the full retrospective method for all periods presented.

As Banner progresses with its implementation efforts to adopt the New Revenue Standard, management continues to evaluate and refine its estimates of the anticipated impacts it will have on its revenue recognition policies, procedures, financial position, results of operations, cash flows, financial disclosures and control framework. Specifically, management is continuing to evaluate its population of revenue sources to determine an appropriate level of stratification, as well as assess all of the potential effects the New Revenue Standard will have on variable consideration arising from settlements with third party payors, disproportionate share hospital payments and bundled payments. However, management does anticipate that, as a result of certain changes required by the New Revenue Standard, the majority of its provision for doubtful accounts will be recognized as a direct reduction to revenues, instead of separately as a deduction to arrive at revenue.

In August 2016, the FASB issued a new financial statement accounting standard for not-for-profit entities. This accounting standard will change the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard will also allow companies to elect to use either the direct or indirect cash flow method, and requires additional liquidity disclosures and presentation of expenses by both natural and functional classification. This accounting standard is effective for fiscal years beginning after December 15, 2017. Management is currently evaluating the impact of adopting this accounting standard.

2. Significant Accounting Policies (continued)

In February 2016, the FASB issued a new lease accounting standard. This accounting standard requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in in its balance sheet. Lessor accounting remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. This accounting standard will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. This accounting standard is effective for fiscal years beginning after December 15, 2018. Management is currently evaluating the impact of adopting this accounting standard.

Reclassifications

The 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation, primarily relating to the reclassification of $10,053,000 of debt issuance costs from other assets to long term debt due to adoption of a new accounting standard.

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:

	2016	**2015**
Commercial, HMO, PPO, and other third-party payors	**43.4%**	45.1%
Medicare	**31.3**	29.1
Medicaid and AHCCCS	**18.0**	19.1
Self-pay	**7.3**	6.7
	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 for identical instruments in active markets. Financial assets in Level 1 primarily include listed equities.

- *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 interpretation, including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates.

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

4. Fair Value Measurements (continued)

(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)

Banner's investment in alternative investments, amounting to approximately $1,316,746,000 and $1,393,565,000 as of December 31, 2016 and 2015, 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. 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 $8,784,000 and $21,518,000 as of December 31, 2016 and 2015, 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 2016 or 2015.

4. Fair Value Measurements (continued)

	December 31, 2016	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)
Cash and cash equivalents	$ 359,018	$ 315,390	$ 43,628	$ –	a
Collateral held under securities lending and repurchase agreement (primarily cash and debt securities)	354,044	234,952	119,092	–	a
Mutual funds:					
Mutual funds – U.S. funds	1,017,063	1,017,063	–	–	a
Mutual funds – International	497,317	497,317	–	–	a
Total mutual funds	1,514,380	1,514,380	–	–	
Debt securities:					
U.S. Treasury/government obligations	240,478	–	240,478	–	a
Corporate bonds/non-U.S. government bonds	180,414	–	180,414	–	a
Asset-backed securities	81,841	–	81,841	–	a
Commercial mortgage-backed securities	12,332	–	12,332	–	a
Non-government-backed collateralized mortgages	17,178	–	17,178	–	a
Government mortgage-backed securities	332,432	–	332,432	–	a
Government commercial-backed	5,730	–	5,730	–	a
Total debt securities	870,405	–	870,405	–	
Repurchase agreements	95,412	–	95,412	–	a
Equity securities:					
U.S. equity securities	196,642	196,642	–	–	a
International equity securities	252,338	252,338	–	–	a
Total equity securities	448,980	448,980	–	–	
Derivative securities:					
Future contracts	284,420	284,420	–	–	a
Forward contracts	345,218	–	345,218	–	a
Interest rate swap agreements	4,703	–	4,703	–	a
Net credit swaps	3,728	–	3,728	–	a
Subtotal derivative assets	638,069	284,420	353,649	–	
Future contracts	(284,420)	(284,420)	–	–	a
Forward contracts	(337,144)	–	(337,144)	–	a
Interest rate swap agreements	(1,971)	–	(1,971)	–	a
Option agreements	(41)	–	(41)	–	a
Net credit swaps	(533)	–	(533)	–	a
Subtotal derivative liabilities	(624,109)	(284,420)	(339,689)	–	
Total fair value investments	$ 3,656,199	$ 2,513,702	$ 1,142,497	$ –	

Short-term investments	$ 217,579
Collateral held under securities lending and repurchase agreements	354,044
Assets limited as to use	2,262,313
Long-term investments	2,070,757
Other assets – Banner Foundation restricted funds	77,036
Less alternative investments	1,316,746
Less split-dollar life insurance	8,784
Total fair value investments	$ 3,656,199

4. Fair Value Measurements (continued)

	December 31, 2015	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)
Cash and cash equivalents	$ 324,925	$ 310,565	$ 14,360	$ –	a
Collateral held under securities lending and repurchase agreement (primarily cash and debt securities)	253,538	155,603	97,935	–	a
Mutual funds:					
Mutual funds – U.S. funds	1,329,336	1,329,336	–	–	a
Mutual funds – International	330,575	330,575	–	–	a
Total mutual funds	1,659,911	1,659,911	–	–	
Debt securities:					
U.S. Treasury/government obligations	299,780	–	299,780	–	a
Corporate bonds/non-U.S. government bonds	230,467	–	230,467	–	a
Asset-backed securities	102,636	–	102,636	–	a
Commercial mortgage-backed securities	27,065	–	27,065	–	a
Non-government-backed collateralized mortgages	11,369	–	11,369	–	a
Government mortgage-backed securities	143,243	–	143,243	–	a
Total debt securities	814,560	–	814,560	–	
Repurchase agreements	10,800	–	10,800	–	a
Equity securities:					
U.S. equity securities	194,488	194,488	–	–	a
International equity securities	292,740	292,740	–	–	a
Total equity securities	487,228	487,228	–	–	
Derivative securities:					
Future contracts	147,195	147,195	–	–	a
Forward contracts	312,816	–	312,816	–	a
Interest rate swap agreements	3,501	–	3,501	–	a
Net credit swaps	570	–	570	–	a
Subtotal derivative assets	464,082	147,195	316,887	–	
Future contracts	(147,195)	(147,195)	–	–	a
Forward contracts	(312,816)	–	(312,816)	–	a
Interest rate swap agreements	(4,645)	–	(4,645)	–	a
Option agreements	(69)	–	(69)	–	a
Net credit swaps	(2,179)	–	(2,179)	–	a
Subtotal derivative liabilities	(466,904)	(147,195)	(319,709)	–	
Total fair value investments	$ 3,548,140	$ 2,613,307	$ 934,833	$ –	
Short-term investments	$ 280,730				
Collateral held under securities lending and repurchase agreements	253,538				
Assets limited as to use	2,205,414				
Long-term investments	2,154,110				
Other assets – Banner Foundation restricted funds	69,431				
Less alternative investments	1,393,565				
Less split-dollar life insurance	21,518				
Total fair value investments	$ 3,548,140				
Interest rate swaps included in other long-term liabilities	$ (361,031)	$ –	$ (361,031)	$ –	c

4. Fair Value Measurements (continued)

Banner received restricted pledges and contributions amounting to $51,993,000 and $46,466,000 for the years ended December 31, 2016 and 2015, respectively, which were subject to fair value measurement on a non-recurring basis. The restricted contributions were measured based on the actual cash received or for pledges receivable, using discounted cash flow projections. Approximately $3,414,000 and $9,143,000 of the restricted contributions was recorded as pledges receivable as of December 31, 2016 and 2015, respectively.

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

	2016	2015
	(In Thousands)	
Interest and dividend income	**$ 49,283**	$ 54,678
Net realized gain on sales of marketable securities	**22,283**	98,901
Gain (loss) from alternative investments, including amount recorded in restricted equity	**40,559**	(24,327)
Net realized (loss) gain on sales of future contracts	**(5,383)**	954
Net realized gain on sales of forward contracts	**–**	16
Net realized gain (loss) on sales of interest rate swap agreements	**791**	(4,250)
Net realized gain (loss) on sales of option agreements	**630**	(877)
Net realized gain (loss) on sales of net credit swaps	**1,882**	(603)
Net unrealized gain (loss) on marketable securities	**59,628**	(131,591)
Net unrealized loss on interest rate swap agreements	**(6)**	(56)
Net unrealized gain on option agreements	**79**	82
Net unrealized gain (loss) on net credit swaps	**1,944**	(803)
	171,690	(7,876)
Less investment gain credited to other revenue, restricted equity, and capitalized bond project funds	**5,274**	2,082
Investment income (loss), net	**$ 166,416**	$ (9,958)

5. Property and Equipment

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

	2016	2015
	(In Thousands)	
Land and land improvements	**$ 324,041**	$ 302,702
Buildings and fixed equipment	**3,566,386**	3,451,925
Major movable equipment	**2,631,624**	2,489,456
Construction-in-progress	**294,764**	111,644
	6,816,815	6,355,727
Less accumulated depreciation and amortization	**3,593,336**	3,249,696
Property and equipment, net	**$ 3,223,479**	$ 3,106,031

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 AIP, a previously unrelated physician network that Banner acquired in June, 2016, 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 the physicians in the AIP 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 BHN 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 is 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.

6. BHN Accountable Care Organization (continued)

In 2016, BHN received approximately $25,510,000 from CMS as its share of the 2015 plan year savings, and in 2015, BHN received approximately $20,714,000 from CMS as its share of the 2014 plan year savings. BHN records the CMS Pioneer Savings in the year received because management is not certain that BHN will meet all of the compliance and quality measures to record the risk share savings prior to receiving the settlement from CMS.

BHN also operates a narrow provider network that contracted with multiple commercial insurance companies during 2016 and 2015. 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, 2016 and 2015, BHN has recorded claims payable, associated with claims incurred but not yet paid of approximately $35,100,000 and $41,010,000, 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:

	2016	2015
	(In Thousands)	
Donor-restricted assets	**$ 183,354**	$ 146,849
Goodwill, net of accumulated amortization of $19,573 in 2016 and 2015	**250,563**	156,166
Investments in unconsolidated affiliates	**109,833**	101,290
Due from Sun Health Services	**33,890**	40,928
Prepaid ground lease with Arizona Board of Regents	**–**	59,000
Intangible assets, net of accumulated amortization of $6,972,000 in 2016 and $4,242,000 in 2015	**15,628**	19,745
Other	**33,973**	17,486
Total other non-current assets	**$ 627,241**	$ 541,464

7. Other Non-current Assets (continued)

The following summarizes the changes in goodwill for the years ended December 31, 2016 and 2015 (in thousands):

January 1, 2015 balance	$ 73,124
UAHN acquisition	69,696
Payson acquisition	10,557
Other, primarily purchase accounting adjustments	2,789
December 31, 2015 balance	156,166
UCE acquisition	**56,535**
UAHN land acquisition	**41,249**
HCP AZ LLC acquisition	**14,621**
Other, primarily purchase accounting adjustments	**2,714**
Goodwill impairment	**(20,722)**
December 31, 2016 balance	**$ 250,563**

Included in investments in unconsolidated affiliates is Banner's 50% investment in Veritage for approximately $28,645,000 and $27,290,000 as of December 31, 2016 and 2015, respectively. Banner's investment in Veritage is accounted for using the equity method of accounting.

Banner holds a 19.7% investment in ExceleraRx Corp. a corporation that provides healthcare systems with access to specialty pharmacy and expertise to provide specialty pharmacy services that is accounted for using the cost method of accounting. Through University Health Plans – University Family Care and University Care Advantage, Banner acquired a 20% interest in Cenpatico of Arizona, Inc., which holds a contract from the state of Arizona to provide behavioral health and medical health services for the indigent mentally ill population in certain central and southern Arizona counties. Banner's investment was $13,739,000 and $10,681,000 as of December 31, 2016 and 2015, respectively, and is accounted for under the equity method of accounting.

Banner is a member of the group purchasing organization of Premier Inc. (Premier) and in connection with this membership, Banner holds a non-controlling interest in Premier that is accounted for under the equity method of accounting. Banner's equity investment in Premier was approximately $24,385,000 and $20,327,000 and Banner's cumulative vendor incentive was approximately $33,137,000 and $23,330,000 as of December 31, 2016 and 2015, respectively.

7. Other Non-current Assets (continued)

Banner's share of Premier's net income recorded under the equity method of accounting and Class B units vendor incentive was approximately $13,865,000 and $14,435,000 in 2016 and 2015, respectively, 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 Corporation (the predecessor of Sun Health Services) in 2008, or at other future Banner projects in the northwestern section of the Phoenix metropolitan area. Sun Health Services committed to contributions of approximately $15,041,000 in 2015 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.

As described above, the Sun Health Support and Maintenance Agreement was significantly modified in 2016 to reduce the annual Baseline Amount, to limit the duration of the Agreement, and remove certain conditions and restrictions in the original Agreement, and to fund the $5,900,000 remaining on its commitment to fund construction at Banner Del E. Webb Medical Center. Sun Health Services also reaffirmed its commitment to fund capital projects previously approved under the original agreement, for which Banner has recorded a restricted receivable of approximately $33,900,000 as of December 31, 2016. Banner recognized a restricted receivable and an addition to restricted net assets of approximately $29,000,000 for future Baseline Support contributions for approved capital expenditures. Under the Amended and Restated Agreement, Sun Health Services agreed to a $60,000,000 Grant Buy-Down, to be used to support Banner's operations in Maricopa County. Banner recorded this grant within other revenue in 2016. Due from Sun Health Services relates to monies 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:

	2016	2015
	(In Thousands)	
Revenue Bonds, Series 2016A, interest 3.13% to 5.00%, due through 2038	**$ 803,500**	$ –
Revenue Bonds, Series 2015A, interest 5.00%, due through 2025	**94,100**	94,100
Weekly Rate Securities Revenue Bonds, Series 2015B, interest due through 2046	**100,630**	100,630
Weekly Rate Securities Revenue Bonds, Series 2015C, interest due through 2046	**100,630**	100,630
Direct Purchase Rate Securities Revenue Bonds, Series 2015D, interest determined monthly, due through 2025	**100,290**	100,290
Taxable loan, interest determined monthly, due through 2022	**100,556**	100,556
Commercial paper, interest determined by dealer at time of issue	**100,000**	100,000
Revenue Bonds, Series 2014A, interest 4.00% to 5.00%, due through 2044	**200,600**	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	**9,665**	13,775
Revenue Bonds, Series 2008A, interest 5.00%, due 2018	**5,735**	207,040
Direct Purchase Rate Securities Revenue Bonds, Series 2008B, interest determined monthly, due through 2035	**84,475**	86,400
Direct Purchase Rate Securities Revenue Bonds, Series 2008C, interest determined monthly, due through 2035	**84,475**	86,400
Revenue Bonds, Series 2008D, interest 5.00% to 5.25%, due through 2018	**36,150**	736,370
Weekly Rate Securities Revenue Bonds, Series 2008E, interest determined weekly, due through 2029	**105,060**	108,780
Weekly Rate Securities Revenue Bonds, Series 2008F, interest determined weekly, due through 2029	**86,185**	89,215
Weekly Rate Securities Revenue Bonds, Series 2008G, interest determined weekly, due through 2029	**81,325**	84,180
Weekly Rate Securities Revenue Bonds, Series 2008H, interest determined weekly, due through 2029	**63,550**	65,780
Revenue Bonds, Series 2007A, interest 5.00%, due through 2017	**11,110**	21,905
Index Rate Bonds, Series 2007B, interest determined quarterly, due through 2037	**400,000**	400,000
Mizuho obligation, interest variable	**–**	200,000
Other	**135,893**	10,673
	2,950,859	3,154,254
Less current portion	**155,949**	353,722
Total long-term debt, less current portion	**$ 2,794,910**	$ 2,800,532

8. Long-Term Debt (continued)

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

2017	$ 155,949
2018	63,182
2019	65,620
2020	68,211
2021	70,218
Thereafter	2,527,679
	$ 2,950,859

Total interest incurred was approximately $145,323,000 and $168,011,000 in 2016 and 2015, respectively, of which $6,280,000 and $2,734,000 was capitalized in 2016 and 2015, respectively. Included within interest costs is approximately $14,771,000 and $32,656,000 of interest expense related to the NCMC, Inc. lease obligation in 2016 and 2015, respectively (see Note 13).

Master Indenture and Bond Indentures

Substantially all of Banner's indebtedness, including its obligations on interest rate swaps, is secured by obligations issued under a master indenture, as supplemented from time to time (the Master Indenture). The Master Indenture provides that all indebtedness secured by obligations issued thereunder is on equal parity with all other such indebtedness. The Master Indenture 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, including all accounts receivable, to secure all indebtedness and other obligations governed by the Master Indenture. Banner was in compliance with these covenants as of December 31, 2016. Banner Health and its two wholly owned subsidiaries, Banner – University Medical Center Tucson Campus, LLC and Banner – University Medical Center South Campus, LLC, are the only members of the Obligated Group responsible for payment of obligations issued under the Master Indenture.

Under the terms of the bond indentures governing each of the bond issues described below, 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 on the accompanying consolidated balance sheets. Security for the payment of principal and interest of certain series of bonds is provided for with direct pay letters of credit issued by third-party banks, as disclosed below.

8. Long-Term Debt (continued)

Interim Debt Arrangements

On February 26, 2015, in order to finance its payment obligations with respect to the UAHN acquisition, Banner entered into a $700,000,000 taxable term loan (interim loan) with Mizuho Bank, Ltd., acting through its New York branch. The interim loan matured on February 25, 2016, and bore interest at a variable rate based on the London Interbank Offered Rate (LIBOR) or the prime rate. The average interest rate for the years ended December 31, 2016 and 2015, was approximately 0.62% and 0.45%, respectively. In November 2015, a portion of the loan amounting to $500,000,000 was paid using proceeds received from the Series 2015 Bonds. On December 31, 2015, $200,000,000 was outstanding, which was paid in full in January, 2016, and the interim loan was terminated.

On April 1, 2015, in order to finance its short-term capital needs with respect to the UAHN and Payson transactions, Banner entered into a $300,000,000 taxable revolving credit loan (revolving credit loan) with Bank of America, N.A. The revolving credit loan was amended to reduce the available line to $175,000,000 on August 11, 2015. The revolving credit loan matured on March 31, 2016, and bore interest at a variable rate based on LIBOR. The average interest rate for the year ended December 31, 2015, was approximately 0.49%. In December 2015, the outstanding balance of $115,000,000 was paid in full. In January 2016, the revolving credit loan was terminated.

The interim loan and revolving credit loan were secured by the Master Indenture.

Series 2016A Bonds

On November 17, 2016, Banner issued its $803,500,000 Series 2016A fixed-rate tax-exempt bonds. The proceeds were used to advance refund and legally defease the Banner Health Series 2008A and Series 2008D Bonds maturing in 2019 through 2038. The Series 2016A bonds are fixed-rate securities, bearing interest at annual interest rates of between 3.13% and 5.00%, and are due in annual installments from 2019 to 2038. The average interest rate for the year ended December 31, 2016, was approximately 4.74%.

8. Long-Term Debt (continued)

Series 2015 Bonds (Series A Through D)

In November 2015:

- Banner issued $94,100,000 of Series 2015A tax-exempt revenue refunding bonds. The proceeds of the bonds were used to legally defease a portion of the Series 2007A bonds amounting to $103,555,000. The Series 2015A bonds are fixed-rate securities, bearing interest at annual interest rates of 5.00%, and are due in annual installments from 2018 to 2025. The average interest rate for the years ended December 31, 2016 and 2015 was 5.00%.

- Banner issued $201,260,000 of Series 2015B-C tax-exempt revenue bonds. The proceeds of the Series 2015B-C bonds were used to partially repay the interim loan with Mizuho Bank, Ltd. and the revolving credit loan with Bank of America, N.A., and to fund the construction of a parking garage at B-UMCP. The Series 2015B-C 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 2015B-C bonds are due in annual installments from 2039 to 2046. The average interest rate for the years ended December 31, 2016 and 2015 was approximately 0.43% and 0.01%, respectively. Security for payment of the Series 2015B-C Bonds is provided for with direct pay letters of credit with the following banks: Bank of Tokyo – Mitsubishi UFJ, Ltd. for the Series 2015B Bonds and Bank of America, N.A. for the Series 2015C Bonds. The direct pay letters of credit for the Series 2015B and Series 2015C bonds terminate in 2021 and 2020, respectively. There were no advances outstanding as of December 31, 2016. The direct pay letters maintains the debt's long term debt classification.

- Banner issued $100,290,000 of Series 2015D tax-exempt revenue bonds. The proceeds of the Series 2015D bonds were used to partially repay the interim loan with Mizuho Bank, Ltd. and the revolving credit loan with Bank of America, N.A., and to fund the construction of a parking garage at B-UMCP. The Series 2015D bonds were issued in direct-purchase index mode and bear interest based on an index plus a spread. Banner entered into a Direct Purchase Agreement for the 2015D Bonds with DNT Asset Trust, a subsidiary of J.P. Morgan International Holdings Limited. The Direct Purchase Agreement maintains the debt's long term classification. The Direct Purchase Agreement expires in 2025. The average interest rate for the years ended December 31, 2016 and 2015, was approximately 0.90% and 0.73%, respectively.

8. Long-Term Debt (continued)

The Series 2015 A-D bonds are secured by the Master Indenture.

2015 Taxable Loan and Commercial Paper Notes

In November 2015:

- Banner entered into a Taxable Loan with The Northern Trust Company in the amount of $100,556,000. The proceeds of the Taxable Loan were used to partially repay the interim loan with Mizuho Bank, Ltd. The Taxable Loan bears interest based on an index plus a spread and matures in 2022. The average interest rate for the years ended December 31, 2016 and 2015, was approximately 1.03% and 0.74%, respectively.

- Banner issued $100,000,000 of taxable 2015 Commercial Paper Notes. The proceeds of the Commercial Paper Notes were used to partially repay the interim loan with Mizuho Bank, Ltd. The 2015 Commercial Paper Notes were issued initially with four $25,000,000 maturities ranging from approximately one to four months. The 2015 Commercial Paper Notes pay interest at maturity and bear interest based on a rate determined by the dealer of the 2015 Commercial Paper Notes at the time of issuance. The average interest rate for the years ended December 31, 2016 and 2015, was approximately 0.53% and 0.31%, respectively. The 2015 Commercial Paper Notes are expected to be remarketed at the time of their respective maturities.

The Taxable Loan and the Commercial Paper Notes are secured by the Master Indenture.

Series 2014A Bonds

In October 2014, Banner issued $200,600,000 of Series 2014A tax-exempt revenue bonds. The proceeds of the bonds were used to fund construction of Banner Fort Collins Medical Center repay interim financing for the acquisition of Banner Casa Grande Medical Center, and fund 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 years ended December 31, 2016 and 2015 was approximately 4.5%.

The Series 2014A bonds are secured by the Master Indenture.

8. Long-Term Debt (continued)

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, 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, 2016 and 2015 was approximately 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, 2016 and 2015 was approximately 4.16%.

The Series 2012 bonds are secured by the Master Indenture.

Series 2008 Bonds (Series A Through H)

In April 2008, Banner issued $227,160,000 of 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 through 2035. The average interest rate for the years ended December 31, 2016 and 2015 was approximately 5.07%. In November 2016, Banner legally defeased the Series 2008A bonds maturing in 2019 through 2035, amounting to $198,705,000.

In June 2008, Banner issued $197,500,000 of 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.

8. Long-Term Debt (continued)

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 and will not be assigned a separate rating by any rating agency, or be registered with The Depository Trust Company or any other securities depository. The Direct Purchase Agreement expires on August 29, 2022. The average interest rate for the years ended December 31, 2016 and 2015 was approximately 1.25% and 1.03%, respectively. The Series 2008B-C bonds are due in annual installments through 2035.

In August 2008, Banner issued $917,860,000 of Series 2008D tax-exempt revenue bonds. The proceeds of these bonds were used to acquire certain assets of Sun Health Corporation (the predecessor of Sun Health Services), 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, 2016 and 2015 was approximately 5.39% and 5.38%, respectively. In November 2016, Banner legally defeased the Series 2008D bonds maturing from 2019 through 2038, amounting to $681,785,000.

In September 2008, Banner issued $397,085,000 of 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, 2016 and 2015 was approximately 0.49% and 0.03%, 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. The direct pay letters of credit maintain the debt's long term classification. All of the direct pay letters of credit terminate between September 2018 and September 2021. There were no advances outstanding as of December 31, 2016.

The Series 2008 bonds are secured by the Master Indenture.

8. Long-Term Debt (continued)

Series 2007 Bonds (Series A and B)

In May 2007, Banner issued $590,920,000 of 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%. In November 2015, Banner legally defeased the Series 2007A bonds maturing from 2018 through 2025, amounting to $103,555,000.

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 three-month LIBOR as determined by the index agent. The average interest rate for the years ended December 31, 2016 and 2015, was approximately 1.27% and 1.00%, respectively.

The Series 2007 bonds are secured by the Master Indenture.

Series 2012 Bank of America Term Loan

On June 6, 2012, Banner entered into a $27,780,000 taxable fixed-rate loan with Bank of America, N.A. term loan, the proceeds of which were used to redeem the bonds still remaining outstanding from the Series 1998A bonds issued by Banner in 1998. The term loan has the same payment amortization schedule as the Series 1998A bonds that were redeemed with the proceeds of the term loan, with a final maturity date of January 1, 2019. The average interest rate for 2016 and 2015 was 1.91%.

The term loan is secured by the Master Indenture.

8. Long-Term Debt (continued)

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%. On May 22, 2015, partial novation of the 2005 Swaps contract was completed from Morgan Stanley to MUFG Union Bank, N.A., increasing the fixed rate to 3.70% or 3.71%. The MUFG Union Bank, N.A. partial novation expires January 6, 2021.

The interest rate swaps did not qualify for hedge accounting treatment under accounting standards for derivative instruments and hedging activities. The derivative mark-to-market adjustments resulted in an unrealized gain of approximately $12,444,000 and $3,259,000 in 2016 and 2015, 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 2016 and 2015 was approximately $16,662,000 and $18,241,000, respectively.

Banner's obligations under the 2005 Swaps agreements are secured by the Master Indenture.

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 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. On May 22, 2015, partial novations of the 2006 Swaps contracts were completed from Morgan Stanley to MUFG Union Bank, N.A. and from Merrill Lynch Capital Services, Inc. to U.S. Bank, N.A., increasing the fixed rate to 3.78%. The MUFG Union Bank, N.A. partial novation expires January 6, 2021, and the U.S. Bank, N.A. partial novation expires July 1, 2021.

8. Long-Term Debt (continued)

The interest rate swaps did not qualify for hedge accounting treatment under accounting standards for derivative instruments and hedging activities. The derivative mark-to-market adjustments resulted in an unrealized gain of approximately $8,731,000 and an unrealized loss of approximately $6,439,000 in 2016 and 2015, respectively, recorded in excess of revenues over expenses. The net realized portion of the interest rate swaps in 2016 and 2015, recorded as an increase to interest expense, was approximately $13,337,000 and $14,062,000, respectively.

Banner's obligations under the 2006 Swaps agreements are secured by the Master Indenture.

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. On May 22, 2015, partial novations of the 2007 Swaps interest rate swap agreements were completed from Morgan Stanley to MUFG Union Bank, N.A. and from Merrill Lynch Capital Services, Inc. to U.S. Bank, N.A., increasing the fixed rate to 4.486%. The MUFG Union Bank, N.A. partial novation expires January 6, 2021, and the U.S. Bank, N.A. partial novation expires July 1, 2021.

The interest rate swaps did not qualify for hedge accounting treatment under accounting standards for derivative instruments and hedging activities. The derivative mark-to-market adjustments resulted in an unrealized gain of approximately $6,791,000 and an unrealized loss of approximately $1,502,000 for 2016 and 2015, respectively, recorded in excess of revenue over expenses. The net realized portion of the interest rate swaps in 2016 and 2015, recorded as an increase to interest expense, was approximately $12,985,000 and $13,907,000, respectively.

Banner's obligations under the 2007 Swaps agreements are secured by the Master Indenture.

Each of the interest rate swap agreements 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, 2016 and 2015, Banner had $101,726,000 and $101,375,000 of collateral outstanding with its counterparties, respectively. The fair value of the collateral is reported as assets limited as to use – other funds on the accompanying consolidated balance sheets.

8. Long-Term Debt (continued)

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, 2019. As of December 31, 2016, there were no draws on the line of credit; however, approximately $11,516,000 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, 2017.

Banner's obligations with respect to this revolving line of credit are secured by the Master Indenture.

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, 2018; Sentry Insurance in the amount of $4,000,000, expiring January 1, 2018; Humana in the amount of $1,663,000, expiring November 19, 2017; City of Fort Collins in the amount of $207,000, expiring October 31, 2017; Liberty Mutual in the amount of $190,000, expiring April 20, 2017; State of Arizona in the amount of $5,000,000, expiring June 3, 2017; Safety National in the amount of $700,000 expiring December 31, 2017; and Zurich America Insurance Company in the amount of $3,300,000, expiring October 31, 2017; and Centers for Medicare and Medicaid in the amount of $595,000, expiring September 30, 2021. No amounts were drawn upon the letters of credit as of December 31, 2016.

Fair Value of Debt and Interest Rate Swaps

As of December 31, 2016 and 2015, the estimated fair value of Banner's debt was $3,011,968,000 and $3,210,320,000, 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, 2016 and 2015, the estimated fair value of the 2005 Swaps resulted in an imputed obligation of $83,483,000 and $96,122,000, respectively, which is recorded in other long-term liabilities on 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 9 years.

8. Long-Term Debt (continued)

As of December 31, 2016 and 2015, the estimated fair value of the 2006 Swaps resulted in an imputed obligation of $140,754,000 and $149,516,000, respectively, which is recorded in other long-term liabilities on 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 23 years.

As of December 31, 2016 and 2015, the estimated fair value of the 2007 Swaps resulted in an imputed obligation of $108,602,000 and $115,393,000, respectively, which is recorded in other long-term liabilities on 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 17 years.

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 several other insurance programs to address claims incurred as part of Banner's ongoing business operations, including directors and officers, auto, environmental, aviation, cybersecurity, property, employee life insurance, and certain physicians' prior acts coverage. Banner is self-insured for several of its insurance programs through its wholly owned captive Banner Indemnity, Ltd. (BIL).

Banner's professional and general liability is self-insured through BIL to which Banner contributes actuarially determined amounts to fund estimated ultimate losses. Starting on July 1, 2015, Banner was self-insured, on a claims-made basis, for the first $15,000,000 of each professional liability claim and the first $10,000,000 in aggregate of general liability claims. BIL also provides an integrated excess liability policy with a single limit of $200,000,000 per occurrence and $200,000,000 aggregate for the three-year term expiring July 1, 2018. Included in this integrated excess policy is a basket aggregate in which amounts paid under the self-insured retentions of the scheduled underlying policies and the separate property, workers' compensation, and environmental policies contribute to the basket aggregate, which is capped at $103,000,000 for the annual period July 1, 2015–July 1, 2016. This policy is fully reinsured by A.M. Best carriers with a minimum rating of A-. Prior to July 1, 2015, Banner was self-insured on an occurrence basis for the first $10,000,000 of professional liability claims, per claim, and the first $10,000,000 of general liability claims, in aggregate, with excess insurance coverage to insure claims made in excess of $10,000,000. The first $25,000,000 of the excess coverage was also self-insured through BIL with

9. Estimated Self-Insurance Liabilities (continued)

the remainder of the excess coverage provided through reinsurance policies issued by unaffiliated third-party insurers. These policies, together with the self-insured components, were in force with aggregate coverage of $225,000,000 for professional and general liability claims.

Banner's workers' compensation coverage is self-insured for the first $1,000,000 per occurrence with BIL providing self-insurance coverage for $500,000 of the $1,000,000 self-insurance coverage for the states of Arizona and Colorado; all other facilities have a deductible of $500,000 per occurrence. Banner has purchased commercial insurance for claims in excess of these retained amounts. 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 BIL 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 $193,315,000 and $202,749,000, of which $43,999,000 and $40,647,000 has been recorded as current liabilities on the accompanying consolidated balance sheets as of December 31, 2016 and 2015, respectively. Self-insurance liabilities are undiscounted at December 31, 2016 and 2015.

10. Non-current Liabilities

Other non-current liabilities consisted of the following as of December 31:

	2016	2015
	(In Thousands)	
Non-current employee benefit liabilities	**$ 76,630**	$ 87,030
Banner Health retirement income plan	**20,537**	18,977
Sun Health Services pension plan	**33,890**	35,002
Asset retirement obligation	**14,422**	14,671
Other	**69,020**	79,692
Total other non-current liabilities	**$ 214,499**	$ 235,372

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. UAHN employees participated in UAHN's defined contribution plan through December 31, 2016 at which point the UAHN defined contribution plan was terminated and the employees were eligible to participate in Banner's defined contribution plan. Contribution expense for both the Banner and UAHN plan in 2016 was $69,790,000, and for the Banner plan was $59,462,000 in 2015.

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, 2016 and 2015, respectively) and components of net periodic benefit costs for the years then ended:

	2016	2015
	(In Thousands)	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	**$ 76,365**	$ 82,076
Interest cost	**3,042**	3,129
Actuarial gain	**(982)**	(3,157)
Benefits paid	**(6,247)**	(5,683)
Projected benefit obligation at end of year	**72,178**	76,365
Change in plan assets		
Fair value of plan assets at beginning of year	**57,388**	61,139
Actual return on plan assets	**501**	(989)
Employer contributions	**–**	2,921
Benefits paid	**(6,247)**	(5,683)
Fair value of plan assets at end of year	**51,642**	57,388
Funded status – accrued benefit recorded	**$ (20,536)**	$ (18,977)
Unrecognized net loss recorded in net assets	**$ 52,290**	$ 52,681

The actuarial gain recorded was primarily due to changes in the discount rate and projections scale in 2015 and use of the new mortality tables in the projected benefit obligation calculation in 2014. The new mortality tables were issued by the Society of Actuaries during 2016 and 2015.

11. Retirement Plans (continued)

The underfunded status of the Plan of $20,536,000 and $18,977,000 at December 31, 2016 and 2015, 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, 2016.

	2016	2015
	(In Thousands)	
Components of net periodic benefit cost		
Interest cost	**$ 3,042**	$ 3,129
Expected return on plan assets	**(4,104)**	(4,252)
Amortization of actuarial loss	**2,264**	2,328
Net periodic benefit cost	**$ 1,202**	$ 1,205

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

	2016	2015
Weighted average discount rate	**4.04%**	4.14%
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.

	2016	2015
Weighted average discount rate	**4.14%**	3.92%
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 55% equity securities, 35% fixed-income securities, and 10% 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, 2016, by asset category, is as follows:

	December 31, 2016	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	**$ 24,534**	**$ 24,534**	**$ –**	**$ –**	**a**
International funds	**12,383**	**12,383**	**–**	**–**	**a**
Common/collective trust funds	**9,740**	**–**	**9,740**	**–**	**a**
Total assets in the fair value hierarchy	**$ 46,657**	**$ 36,917**	**$ 9,740**	**$ –**	
Investments measured at net asset value:					
Alternative investments	**$ 4,985**				
	$ 51,642				

The fair value of the Plan's assets at December 31, 2015, by asset category, is as follows:

	December 31, 2015	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	$ 21,842	$ 21,842	$ –	$ –	a
International funds	13,361	13,361	–	–	a
Common/collective trust funds	9,285	–	9,285	–	a
Total assets in the fair value hierarchy	$ 44,488	$ 35,203	$ 9,285	$ –	
Investments measured at net asset value:					
Alternative investments	$ 12,900				
	$ 57,388				

11. Retirement Plans (continued)

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

Expected employer contributions in 2017	$ 1,870
Expected benefit payments:	
2017	5,579
2018	5,599
2019	5,542
2020	5,444
2021	5,359
2022–2026	25,050

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 salary benefits were not frozen until 2014. At December 31, 2016 and 2015, Banner recorded a non-current liability of $33,890,000 and $35,002,000, respectively, representing the unfunded liability under the Sun Health Pension Plan, and a long-term receivable from Sun Health Services in the same amount on the accompanying consolidated balance sheets.

11. Retirement Plans (continued)

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, 2016 and 2015, respectively):

	2016	2015
	(In Thousands)	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	**$ 104,410**	$ 109,248
Service cost	**49**	91
Interest cost	**4,392**	4,380
Actuarial gain	**(1,173)**	(4,749)
Benefits paid	**(4,591)**	(4,560)
Projected benefit obligation at end of year	**103,087**	104,410
Change in plan assets		
Fair value of plan assets at beginning of year	**69,408**	71,936
Actual return on plan assets	**693**	(1,017)
Employer contributions	**3,687**	3,050
Benefits paid	**(4,591)**	(4,561)
Fair value of plan assets at end of year	**69,197**	69,408
Funded status – accrued benefit recorded	**$ (33,890)**	$ (35,002)

The assumptions used to determine the projected benefit obligation include the weighted average discount rate of 4.26% and 4.31% as of December 31, 2016 and 2015, respectively, and weighted average expected long-term rate of return on plan assets of 7.00% as of December 31, 2016 and 2015.

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.

11. Retirement Plans (continued)

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 55% equity securities, 35% fixed-income securities, and 10% 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, by asset category, is as follows:

	2016	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	$ 31,686	$ 31,686	$ –	$ –	a
International funds	17,569	17,569	–	–	a
Common/collective trust funds	12,889	–	12,889	–	a
Total assets in the fair value hierarchy	$ 62,144	$ 49,225	$ 12,889	$ –	
Investments measured at net asset value:					
Alternative investments	$ 7,053				
	$ 69,197				

11. Retirement Plans (continued)

	2015	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	$ 26,323	$ 26,323	$ –	$ –	a
International funds	17,544	17,544	–	–	a
Common/collective trust funds	10,796	–	10,796	–	a
Total assets in the fair value hierarchy	$ 54,663	$ 43,867	$ 10,796	$ –	
Investments measured at net asset value:					
Alternative investments	$ 14,745				
	$ 69,408				

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

Expected employer contributions in 2017	$ 4,202
Expected benefit payments:	
2017	5,043
2018	5,232
2019	5,479
2020	5,735
2021	5,975
2022–2026	31,843

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 $143,747,000 and $127,060,000 for the years ended December 31, 2016 and 2015, respectively.

11. Retirement Plans (continued)

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 $5,536,000 and $5,832,000 for the years ended December 31, 2016 and 2015, respectively.

Supplemental Executive Retirement Plan

Banner has a supplemental executive retirement plan for certain senior executives' retirement and death benefits. Banner's executive retirement plan expense was $8,340,000 and $10,002,000 for the years ended December 31, 2016 and 2015, respectively. The liability was approximately $29,910,000 and $26,669,000 as of December 31, 2016 and 2015, respectively, of which $25,164,000 and $0 is current as of December 31, 2016 and 2015, respectively. The liability has been discounted to present value using a discount rate of 3.32% and 4.03% in 2016 and 2015, respectively.

12. Income Taxes

Banner's deferred tax assets are primarily related to BHN and the University Health Plans. Deferred tax assets consist of the following as of December 31:

	2016	2015
	(In Thousands)	
Deferred tax assets:		
Net loss carryforwards	**$ 78,175**	$ 29,061
Accrued compensation	**356**	365
Accrued expenses	**2,573**	3,626
Total deferred tax assets	**81,104**	33,052
Deferred tax liabilities:		
Depreciation	**(323)**	(274)
Accrued expenses	**(501)**	–
Total deferred tax liabilities	**(824)**	(274)
Valuation allowance	**(71,941)**	(28,889)
Net deferred tax asset after valuation allowance	**$ 8,339**	$ 3,889

12. Income Taxes (continued)

As of December 31, 2016, Banner had estimated federal net operating loss carryforwards of $195,393,000 that begin to expire in the year 2034 and estimated state net operating loss carryforwards of $195,393,000 that begin to expire in 2018. A valuation allowance of $71,941,000 and $28,889,000 at December 31, 2016 and 2015, 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, are in a taxpaying position and, therefore, more likely than not to realize the tax benefit.

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

	2016	2015
	(In Thousands)	
Computed tax benefit at 34%	**$ 49,916**	$ 22,770
State taxes net of federal benefit	**4,021**	1,397
Change in valuation reserve	**(43,051)**	(17,536)
Permanent items	**(101)**	(42)
Other	**1,191**	1,465
	$ 11,976	$ 8,054

Banner has not recorded any expense or accrued for any related expense for any uncertain tax positions. Banner's 2013 through 2016 tax years remain subject to examination for federal income tax purposes, whereas the 2012 through 2016 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, 2016 (in thousands):

2017	$ 29,938
2018	25,162
2019	21,105
2020	16,784
2021	13,021
Thereafter	30,531
	$ 136,541

Amounts charged to expense for all operating leases totaled $129,305,000 and $122,499,000 in 2016 and 2015, respectively.

Operating Agreements

North Colorado Medical Center

Banner has 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. since 1995.

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 sublease through December 31, 2027. Under the Second Amended Operating Agreement, Banner is required to pay rent to NCMC, Inc. monthly under the following rent formula: (i) asset depreciation expense in an amount equal to the total actual asset depreciation expense of NCMC, Inc. for the acute care assets and most other assets subleased to Banner; (ii) a return on most of the assets included in the asset depreciation expense component, excluding certain infrastructure improvement assets, in an amount equal to 8% of the year-end net book value of such assets; (iii) a return on assets in an amount equal 4% of the year-end net book value of approximately $60,000,000 of infrastructure improvements made by NCMC,

13. Commitments and Contingencies (continued)

Inc. to NCMC from 2012 to 2014; and (iv) rent for certain real existing and future property used for ancillary health care operations based on a fair market value rent as negotiated by the parties. 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 $5,000,000 in 2015, $5,000,000 in 2016, 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, 2016, management has determined that it is probable that Banner will be paying an additional lease payment in 2017 based on the projected five-year cumulative operating income for NCMC of which Banner has accrued $14,631,000 as of December 31, 2016.

During 2012, NCMC, Inc. commenced the $60,000,000 infrastructure improvement construction project at NCMC. In accordance with the lease accounting standards, Banner was considered to have substantially all of the risks of ownership of NCMC during the construction period as Banner continues to pay rent during the construction period. Accordingly, Banner has recorded an asset titled Leased Hospital assets and a corresponding obligation titled Hospital Lease obligation of $205,951,000 in 2012, and an additional asset and corresponding obligation of $36,534,000 and $40,227,000 were recorded in 2016 and 2015, 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, 2016 and 2015, amounted to $27,376,000 and $23,907,000, respectively. Interest expense recorded by Banner on the lease obligation with NCMC, Inc. amounted to $14,244,000 and $13,556,000 for the years ended December 31, 2016 and 2015, respectively.

13. Commitments and Contingencies (continued)

Total payments made to NCMC, Inc. amounted to $38,680,000 and $35,508,000 for the years ended December 31, 2016 and 2015, respectively.

Greater Fairbanks Community Hospital

Banner leased 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 obligated 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 obligated the Foundation to purchase all future equipment for the Facility. In addition to the basic rent, additional rent payments were 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 retained the operating income from the Facility, up to 4.50% of the total revenue, and paid the balance of the operating income to the Foundation as additional rent. Rental expense under the Facility's operating lease totaled $51,517,000 and $44,407,000 for the years ended December 31, 2016 and 2015, respectively.

In December 2015, Banner exercised its right to terminate the lease upon at least one year's notice. The termination was effective January 1, 2017. Included in Banner's consolidated statements of income for the years ended December 31, 2016 and 2015, respectively, is $296,072,000 and $271,460,000 of total revenue and $(3,474,000) and $149,000 of operating (loss) income related to the Facility. Under the Lease Termination and Sale Agreement, Banner sold accounts receivable of the hospital and nursing facility to the Foundation at a 15% discount, which has been recorded as a reduction of the accounts receivable balance and recorded in other operating expense. Assets to be purchased and liabilities assumed by the Foundation are $42,900,000 and $2,757,000, respectively, at December 31, 2016. Total termination costs recorded in other expenses are $9,014,000.

In 2015, the Foundation commenced a construction project at the Facility for a surgical building. In accordance with the lease accounting standards, Banner was considered to have substantially all of the risks of ownership of the surgical building during the construction period as Banner continued to pay rent during the construction period. Accordingly, Banner has recorded an asset and a corresponding obligation associated with the construction costs of the surgical building amounting to $66,125,000 as of December 31, 2016. Upon termination of the lease, the asset and obligation will be removed.

13. Commitments and Contingencies (continued)

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 2004 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 Fairbanks Hospital. In 2009, Banner entered into three additional limited guarantees of the scheduled 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. Pursuant to their terms, the limited guarantees automatically terminated simultaneously with the termination of the lease.

Banner's obligations under the foregoing guarantees of the Foundation's obligation to pay principal and interest on the Bonds terminated simultaneously with the termination of the lease for the Facility, excluding any liability for any unpaid scheduled payments of debt service on the Bonds that became due and owing prior to the effective date of the lease termination. Therefore Banner did not record a liability for the limited guarantee at December 31, 2016.

Washakie Medical Center

Prior to May 14, 2015, Banner leased Washakie Medical Center (WMC) from the Board of Trustees of Memorial Hospital of Washakie County, Wyoming (Hospital Board) with the approval and consent of the Board of County Commissioners of Washakie County, Wyoming (County) pursuant to a lease agreement, as amended (Original Lease). Under the Original Lease, Banner was required to pay rent to the Hospital Board monthly in the amount of $12,500. Banner furnished and maintained substantially all equipment used in WMC operations.

The County issued bonds in May, 2015, to substantially renovate and expand the existing WMC facility. Construction has begun, and Banner is required under generally accepted accounting principles to record the lease, as defined below, as a capital lease. When construction is completed, Banner will evaluate the lease to see if it qualifies for sale-leaseback treatment under generally accepted accounting principles. Banner recorded leased assets and lease obligation of $24,426,000 for the WMC Lease as of December 31, 2016.

13. Commitments and Contingencies (continued)

Effective as of May 13, 2015, Banner entered into an amended and restated lease agreement with the County and the Hospital Board (together, the Landlord) (the Lease). The Lease extended the term of the Original Lease through May 13, 2045. Under the Lease, Banner is required to pay basic rent to the Hospital Board in the amount of $150,000 annually, plus inflation of 3% each year, beginning June 1, 2015 through June 1, 2029. Beginning June 1, 2030, Banner is required to pay base rent of $500,000 annually, plus 3% annual inflation, through the end of the Lease term. Additional annual rent of $1,797,494 is to be paid in monthly installments of $149,791 directly to the Bond Trustee, beginning June 3, 2015 through June 3, 2029. Additionally, Banner is responsible for paying the annual fees of the Bond Trustee in the amount of approximately $3,000.

Under the terms of the Lease, Banner is responsible to maintain, replace, and upgrade hospital equipment at WMC to aid in the provision of quality patient care in an equivalent manner to its similarly situated owned and operated critical access hospitals.

The Lease can be terminated at any time by mutual agreement of the parties. Banner can terminate the Lease upon one year written notice to the Landlord, to be effective beginning on the 16^{th} anniversary of the Lease. The Landlord can terminate the Lease upon one year written notice to Banner, to be effective beginning on the 21^{st} anniversary of the Lease.

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, 2016, $231,162,000 (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

13. Commitments and Contingencies (continued)

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, 2016 or 2015.

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 $767,000,000 (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 $3,991,000 and $2,849,000 to MD Anderson for the years ended December 31, 2016 and 2015, respectively.

Cenpatico of Arizona, Inc.

As stated in Note 7, in 2015, Banner acquired a 20% interest in Cenpatico of Arizona, Inc. (Cenpatico), which holds a contract with the state of Arizona to provide behavioral and medical health services for the indigent seriously mentally ill population in certain central and southern Arizona counties, through its wholly owned subsidiaries. These subsidiaries are obligated to fund 20% of 300% of the statutorily required risk-based capital of Cenpatico. As of December 31, 2016, Banner's investment was $13,739,000.

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.

OIG Patient Status Investigation

In June 2015, Banner was served with a subpoena from the Office of Inspector General of the U.S. Department of Health and Human Services (OIG) seeking a large number of medical records for cases dating back to 2009, as well as documentation from 2009 to 2015 pertaining to Banner's practices and procedures for classifying patients as inpatients, outpatients, or observation status patients. Based on communications with the OIG and the U.S. Department of Justice, management believes that the subpoena reflects a substantial investigation concerning patient status. Banner has begun producing the requested records and other materials, and intends to cooperate with the investigation. At this point, it is not possible to estimate the ultimate outcome of the investigation. Similar investigations have been tied to qui tam litigation brought under the federal False Claims Act and have resulted in substantial settlements against other health care systems, and management believes that it is likely that an as-yet unsealed qui tam lawsuit is pending related to the investigation.

13. Commitments and Contingencies (continued)

401(k) Plan Litigation

In November 2015, Banner and a number of affiliated individuals were sued in federal district court in a putative class action brought on behalf of all current and certain former Banner employees participating in Banner's 401(k) defined contribution retirement plan. The complaint alleges a variety of acts and omissions relating to the administration of the 401(k) plan, including excessive and poorly performing investment options, excessive administration, investment and record-keeping fees, and conflicts of interest. The acts and omissions are alleged to constitute violations of fiduciary duty and of the Employee Retirement Income Security Act (ERISA). Banner intends to defend the case vigorously. While some of the similar class actions against other sponsors of large 401(k) plans have resulted in substantial liability to the employer, it is too early to provide an estimate as to the likelihood of an unfavorable outcome or the range of potential damages in the event of an unfavorable outcome. The extent of insurance coverage for this claim has not yet been settled.

UAHN 340B Self-Disclosure

During the course of due diligence prior to the UAHN acquisition in 2015, issues were identified with respect to whether UAHN had acquired pharmaceuticals under the federal 340B Drug Discount Pricing Program for individuals who were not eligible for participation in the program, and whether UAHN was in compliance with the prohibition applicable to entities participating in the 340B program from purchasing drugs through a group purchasing program. The potential non-compliance has been disclosed to the Health Resources and Services Administration (HRSA), the federal agency that administers the 340B program, and Banner implemented procedures to address the potential non-compliance on a prospective basis. HRSA requested that Banner enter into corrective action plans to address this non-compliance which include an obligation to provide notice to and repayment of the various pharmaceutical manufacturers for the cost difference of the applicable pharmaceuticals. Banner is continuing to follow the corrective action plans and Banner has begun repaying the manufacturers, as requested. The approximate total repayment is expected to be $5.8 million.

13. Commitments and Contingencies (continued)

June 2016 Cyber Attack and Resulting Class Actions

In late June 2016, Banner identified activity within its computer network indicating that a cyber-attack may have occurred. An investigation was launched immediately with the assistance of an independent computer forensics firm, which revealed that the attack was initiated on June 17, 2016. It has been determined that Banner computer systems that process credit card payments in food and beverage outlets at some Banner locations were accessed by unauthorized persons, resulting in the copying of approximately 21,000 credit card numbers. It has also been determined that the cyber attackers may also have gained access to a number of Banner servers, containing personal and patient information of approximately 3.7 million individuals, including patients and providers. The attack was publicly disclosed on August 3rd, and law enforcement and appropriate regulatory authorities have been notified. Following discovery, Banner implemented actions to remove the malware, remedy the damage to the network, and enhance the security of its network. Banner has also directly notified those individuals which it can identify as potentially having had their personal and patient information improperly accessed, and is offering ongoing monitoring and other steps to protect those who may have been affected by the breach.

Nine putative class action lawsuits have been filed against Banner, seeking damages and other remedies on behalf of individuals possibly affected by the incident. Banner anticipates that these cases will be consolidated into a single lawsuit, and intends at this time to defend them vigorously. At this point, the full extent of potential loss incurred in connection with the investigation notification, mitigation and remediation of the attack, and the likelihood and extent of potential liability in the pending lawsuits are not known. The extent of insurance coverage for any potential liability has not yet been settled, although management believes at this time that a substantial portion of the potential exposure from the cyber-attack and ensuring litigation will be covered by its cyber risk insurance program.

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.

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