UPMC
LIFE CHANGING MEDICINE

UPMC Quarterly Disclosure

For the Period Ended June 30, 2017

UPMC QUARTERLY DISCLOSURE

FOR THE PERIOD ENDED JUNE 30, 2017

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The following financial data is derived from both the June 30, 2017 audited consolidated financial statements of UPMC and the unaudited interim consolidated financial statements of UPMC. The interim financial data includes all adjustments consisting of a normal recurring nature that UPMC considers necessary for a fair presentation of its financial position and the results of operations for these periods. Operating and financial results reported herein are not necessarily indicative of the results that may be expected for any future periods.

The information contained herein is being filed by UPMC for the purpose of complying with its obligations under Continuing Disclosure Agreements entered into in connection with the issuance of the series of bonds listed herein and disclosure and compliance obligations in connection with various banking arrangements. The information contained herein is as of June 30, 2017. Digital Assurance Certification, L.L.C., as Dissemination Agent, has not participated in the preparation of this Unaudited Quarterly Disclosure, has not examined its contents and makes no representations concerning the accuracy and completeness of the information contained herein.

UPMC LIFE CHANGING MEDICINE

INTRODUCTION TO MANAGEMENT'S DISCUSSION AND ANALYSIS

PERIOD ENDED JUNE 30, 2017

UPMC, doing business as the University of Pittsburgh Medical Center, is one of the world's leading integrated delivery and financing systems ("IDFS"). UPMC is based in Pittsburgh, Pennsylvania and primarily serves residents of western Pennsylvania. We also draw patients for highly specialized services from across the nation and around the world. UPMC's more than 25 hospitals and more than 600 clinical locations comprise one of the largest nonprofit health systems in the United States. UPMC has three major divisions: Health Services, Insurance Services, and UPMC Enterprises.

We are committed to providing the communities that our hospitals, outpatient centers and other health care facilities serve, as well as our insurance members, with high quality, cost-effective health care while continuing to grow our business and execute on our mission to provide Life Changing Medicine. As the stewards of UPMC's community assets, we are guided by our core values of integrity, excellence, respect and teamwork. These values govern the manner in which we serve our communities and are embedded in the execution and delivery of Life Changing Medicine.

UPMC continues to make significant investments in equipment, technology, education and operational strategies designed to improve clinical quality at our hospitals and outpatient centers. As a result of our efforts, UPMC is currently ranked number 14 on the *U.S. News & World Report* Best Hospitals Honor Roll. Investments in our operations and continued capital improvements are expected to become increasingly important as the competitive environment of the western Pennsylvania market and changes to health care nationally continue to progress and change the landscape of patient care and reimbursement. We build new facilities, make strategic acquisitions, and enter into joint venture arrangements or affiliations with health care businesses — in each case in communities where we believe our mission can be effectively utilized to improve the overall health of those communities.

By continually evolving and refining UPMC's world-class financial processes, we focus on achieving optimal financial results that support the continued development of our organization, as well as ongoing investment in the future of Pennsylvania. We are committed to achieving these objectives with unyielding commitments to transparency in reporting and disclosure, enterprise-wide integration, and ongoing process improvement.

The purpose of this section, Management's Discussion and Analysis ("MD&A"), is to provide a narrative explanation of our financial statements that enhances our overall financial disclosures, to provide the context within which our financial information may be analyzed, and to provide information about the quality of, and potential variability of, our financial condition, results of operations and cash flows.

Unless otherwise indicated, all financial and statistical information included herein relates to our continuing operations, with dollar amounts expressed in thousands (except for statistical information). MD&A should be read in conjunction with the accompanying consolidated financial statements.

CONSOLIDATED FINANCIAL HIGHLIGHTS

(Dollars in millions)

Financial Results for the Twelve Months Ended June 30	**2017**	2016
Operating revenues	**$ 14,347**	$ 12,848
Operating income	**$ 240**	$ 310
Operating margin	**1.7 %**	2.4%
Operating margin (including income tax and interest expense)	**0.8 %**	1.3%
Gain (loss) from investing and financing activities	**$ 302**	$ (153)
Excess of revenues over expenses	**$ 991**	$ 134
Operating EBIDA	**$ 732**	$ 767
Capital expenditures	**$ 548**	$ 384
Reinvestment ratio	**1.11**	0.84

Selected Other Information as of	**June 30, 2017**	June 30, 2016
Total cash and investments	**$ 5,951**	$ 5,096
Unrestricted cash and investments	**$ 5,019**	$ 4,325
Unrestricted cash and investments over long-term debt	**$ 1,771**	$ 1,380
Days of cash on hand	**133**	130
Days in net accounts receivable	**43**	49
Average age of plant	**10.4**	10.1

Operating revenues for the twelve months ended June 30, 2017 increased $1.5 billion, or 12%, as compared to the twelve months ended June 30, 2016. Operating income for the twelve months ended June 30, 2017 decreased $70 million over the same period in the prior fiscal year. Operating earnings before interest, depreciation and amortization totaled $732 million, and excess of revenues over expenses was $991 million. As of June 30, 2017, UPMC had nearly $6.0 billion of cash and investments.

For the twelve months ended June 30, 2017:

- Hospital medical-surgical admissions and observation cases increased 9% compared to the prior year.
- Hospital outpatient revenue per workday increased 15% compared to the prior year.
- Physician service revenue per weekday increased 10% from the comparable period in the prior year, and
- Enrollment in UPMC's Insurance Services grew to 3.2 million members as of June 30, 2017.

UPMC's gain from investing and financing activities for the twelve months ended June 30, 2017 was $302 million. UPMC made no material changes to its asset allocation policies during the quarter and continues to have a long-term perspective with regard to its investment activities.

UPMC's model of providing exceptional care at an affordable price is in high demand in communities that extend beyond western Pennsylvania. Meeting that demand, UPMC continues to grow and expand by adding new locations to extend world-class patient care and keep it close to home in the communities where it is needed most. Leveraging UPMC's long-standing commitment to world-class health care, nonprofit health care organizations are increasingly pursuing affiliation arrangements with UPMC as a strategic imperative to strengthen their local health care effectiveness, to integrate leading clinical and nonclinical practices, to extend population health initiatives, and to improve cost effectiveness. By seeking affiliation with UPMC, nonprofit health organizations operating from a position of financial strength and in pursuit of strategic goals create an extended operating platform that contributes to a stronger healthcare provider in that particular region.

In March 2017, PinnacleHealth System, based in Harrisburg, Pa., and UPMC signed a letter of intent to pursue an affiliation that would allow Pinnacle to enhance clinical and population health management capabilities to better serve the residents of central Pennsylvania. Following a due diligence process, Pinnacle and UPMC on July 28, 2017 entered into an integration and affiliation agreement in which, among other things, UPMC would become the parent and sole member of Pinnacle, and Pinnacle would be renamed UPMC Pinnacle. Both parties expect an effective date on or around September 1, 2017, subject to regulatory review and the satisfaction of customary closing conditions. Separately, Pinnacle on July 1, 2017, completed its acquisition of Memorial Hospital of York, Lancaster Regional Medical Center, Heart of Lancaster Regional Medical Center in Lititz, and Carlisle Regional Medical Center. In addition, on July 24, 2017, Pinnacle and Hanover HealthCare PLUS, the parent organization of Hanover Hospital in Hanover, Pa., signed a binding affiliation agreement as the next step in finalizing the process for Hanover Hospital to become a member of the Pinnacle network. Under the agreement, Hanover HealthCare PLUS, its physician network and other facilities will also become part of Pinnacle. Subject to regulatory approval, the transaction is expected to be completed on or around September 1, 2017. Pinnacle will include eight hospitals, along with a network of physician practices, and ambulatory surgery and outpatient centers among other health facilities.

In June 2017, Cole Memorial Hospital in Coudersport, Pa., signed a letter of intent to integrate Cole Memorial into the UPMC network. UPMC Susquehanna, which integrated with UPMC in October 2016, would provide management services to what would become UPMC Cole. UPMC Susquehanna's close geographic distance to Cole and their historical working relationship would allow for a seamless evolution. Cole also has partnered with UPMC Hamot for almost 10 years on cardiology services. Leaders are conducting further discussions and due diligence to work toward a definitive agreement.

Also in June 2017, UPMC Susquehanna signed an asset purchase agreement to acquire Lock Haven Hospital in Lock Haven, Pa., and Sunbury Community Hospital in Sunbury, Pa. The transaction would allow the hospitals to reinvest in their facilities, grow services and improve local access to quality care. Closing is planned for Fall 2017.

In May 2017, UPMC announced its final payment of $41 million to completely fulfill its $100 million, 10-year pledge made in 2007 to launch The Pittsburgh Promise. The Promise is a postsecondary scholarship program for Pittsburgh Public Schools students, advocating for improving the quality of education and increasing the preparedness and diversity of the region's workforce. Pittsburgh has the largest Promise program in the United States due to UPMC's investment and so far has provided scholarships for 7,298 students. Developed in collaboration with the City of Pittsburgh and the Pittsburgh Public Schools, the Promise gives graduates of Pittsburgh's public high schools the means to pursue a postsecondary education at an accredited institution in Pennsylvania. With UPMC leading the way, total support for The Promise has reached $194 million to date

In April 2017, Avalon Nursing Center and Avalon Springs Nursing Center became part of UPMC Senior Communities. Avalon Nursing Center, an 84-bed skilled nursing facility in New Castle, becomes Avalon Place, and Avalon Springs Nursing Center, a 100-bed skilled nursing facility in Mercer, Pa., becomes Avalon Springs Place. Both facilities specialize in complex medical care and short-term rehabilitative services. The integration of these facilities into UPMC positions Avalon to advance senior resident care services through facility improvements, information technology upgrades, staff learning and development, and access to UPMC's innovative geriatric specialty services and research. It preserves Avalon's mission to continue nonprofit care delivery, serving Mercer and Lawrence counties. Avalon facilities will continue their strong ties as post-acute care providers in the shared regional marketplace of UPMC Horizon and UPMC Jameson. UPMC Senior Communities now encompasses 21 facilities, with more than 2,900 residents, extending UPMC's world-class senior care throughout seven counties in Pennsylvania.

UPMC continues to invest capital and resources to meet the increasing demand for its world-class outpatient care in communities throughout central Pennsylvania. In May 2017, UPMC Altoona opened Logan Medical Building in Hollidaysburg, Pa. This newly constructed $28 million, 90,000-square-foot facility provides family medicine and multi-specialty services, including Children's Community Pediatrics, locally for residents of central and southern Blair County. Meanwhile, construction continues on a $20 million outpatient facility in Ebensburg, Pa. The three-story, 46,500-square-foot building will extend UPMC Altoona's outpatient primary and specialty care and diagnostic services closer to home for residents of Ebensburg and Cambria County, and is expected to open in early 2018. In Hampton, Pa., construction is nearly completed on the three-story, 44,000-square-foot Hampton Outpatient Center, scheduled to open in early September 2017. The $19 million facility will house an array of radiological and laboratory diagnostics, vast and comprehensive primary care services, including women's health, pediatrics, physical rehabilitation, and community-oriented services such as diabetes education and flu clinics. In July 2017, UPMC Jameson finalized the transition of its ground floor into a comprehensive outpatient services center that also is home to the UPMC Heart and Vascular Institute's northern hub. This is part of UPMC's $13 million investment in facility upgrades at Jameson since the May 2016 affiliation.

In May 2017, Gov. Tom Wolf joined UPMC leaders in Erie, Pa., to announce a $12 million investment by UPMC and UPMC Health Plan to open a new business operations center in Erie in Fall 2017, creating nearly 200 new full-time jobs with expectations for future expansion. UPMC Hamot purchased a 70,000-square-foot building along Erie's East Bayfront Parkway to serve as a new operations center for UPMC Health Plan and UPMC hospital support services. UPMC Hamot received a funding proposal from the Department of Community and Economic Development for a $300 thousand Pennsylvania First grant, coordinated by the Governor's Action Team, a group of economic development professionals who report directly to the governor and work with businesses that are considering locating or expanding in Pennsylvania. The May announcement complements UPMC's announcement in December 2016 of its $111 million investment in UPMC Hamot's new patient tower project, scheduled to be completed in 2020. Since 2011, UPMC has invested more than $190 million to benefit the Erie region and support the revitalization of downtown Erie.

In June 2017, UPMC Community Provider Services purchased Jefferson Hospital's share of a jointly owned home health agency. Formerly known as UPMC Jefferson Regional Home Health, the agency's name has changed to UPMC Home Healthcare. Home health services continue seamlessly to patients throughout western Pennsylvania, covering 22 counties and serving roughly 40,000 individuals each year who have comprehensive nursing and rehabilitation needs. The transition renews UPMC's investment in its largest home health agency as a fully integrated and important member of the continuum of care provided to patients throughout UPMC. It also enhances UPMC's ability to care for patients at home as we add new services, continue to integrate electronic medical records into home care, and expand sophisticated technology such as in-home telemonitoring—all of which will more closely connect UPMC's home-based services with all other parts of the health service continuum that UPMC provides.

In August 2017, for the 18th year, UPMC was named to the *U.S. News & World Report* Best Hospitals Honor Roll weeks after *U.S. News & World Report* named Children's Hospital of Pittsburgh of UPMC ("Children's") to its Best Children's Hospitals Honor Roll as one of "America's Best Children's Hospitals" for the 8th consecutive year. UPMC earned 14th position on the Honor Roll, which includes only 20 hospitals. UPMC is ranked among the top 10 hospitals in three specialties. Children's earned 9th place on the Best Children's Hospitals Honor Roll, ranking in all 10 pediatric specialties.

Two more UPMC hospitals earned or re-earned the coveted Magnet® Recognition, granted by the American Nurses Credentialing Center and achieved by only 8 percent of hospitals nationwide. In May 2017, UPMC Passavant earned the designation for the first time, and in July 2017, Children's earned Magnet re-designation since first becoming a Magnet hospital in 2012. The ANCC Magnet Recognition Program® recognizes health care organizations for quality patient care, nursing excellence, and innovations in professional nursing practice. Of more than 6,300 health care organizations nationwide, only 468 have achieved Magnet designation status. The other UPMC Hospitals with Magnet designation include UPMC Hamot, UPMC Shadyside and UPMC St. Margaret.

UPMC in July 2017 was named one of the nation's 461 "Most Wired" health care organizations by the American Hospital Association's Health Forum, marking UPMC's 19th year on the annual list. The 2017 results are based on a survey completed by almost 40 percent of hospitals in the U.S. The survey measures information technology use and adoption among hospitals nationwide and examines how they are leveraging technology—including data analytic tools, telehealth systems and remote monitoring—to improve performance and value for patients. The 461 hospitals met specific requirements across four focus areas: infrastructure; business and administrative management; clinical quality and safety; and clinical integration. Over the past five years, UPMC has invested more than $1.5 billion in technology to support clinical excellence and administrative efficiency.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

Twelve Months Ended June 30, 2017 *(in millions)*

Revenues:	Health Services	Insurance Services	Eliminations	Consolidated
Net patient service revenue less provision for bad debts	$ 8,129	$ –	$ (1,783)	$ 6,346
Insurance enrollment revenue	–	6,811	–	6,811
Other revenue	916	373	(99)	1,190
Total operating revenues	$ 9,045	$ 7,184	$ (1,882)	$14,347
Expenses:				
Salaries, professional fees and benefits	$ 4,885	$ 299	$ (29)	$ 5,155
Insurance claims expense	–	6,200	(1,783)	4,417
Supplies, purchased services and general	3,571	542	(70)	4,043
Depreciation and amortization	484	8	–	492
Total operating expenses	8,940	7,049	(1,882)	14,107
Operating income	$ 105	$ 135	–	$ 240
Operating margin %	1.2%	1.9%	–	1.7%
Operating margin % (including income tax and interest expense)	0.0%	1.5%	–	0.8%
Operating EBIDA	$ 589	$ 143	–	$ 732
Operating EBIDA %	6.5%	2.0%	–	5.1%

Twelve Months Ended June 30, 2016 *(in millions)*

Revenues:	Health Services	Insurance Services	Eliminations	Consolidated
Net patient service revenue less provision for bad debts	$ 7,233	$ –	$ (1,564)	$ 5,669
Insurance enrollment revenue	–	6,141	–	6,141
Other revenue	838	312	(112)	1,038
Total operating revenues	$ 8,071	$ 6,453	$ (1,676)	$12,848
Expenses:				
Salaries, professional fees and benefits	$ 4,319	$ 261	$ (27)	$ 4,553
Insurance claims expense	–	5,560	(1,564)	3,996
Supplies, purchased services and general	3,109	508	(85)	3,532
Depreciation and amortization	449	8	–	457
Total operating expenses	7,877	6,337	(1,676)	12,538
Operating income	$ 194	$ 116	–	$ 310
Operating margin %	2.4%	1.8%	–	2.4%
Operating margin % (including income tax and interest expense)	1.0%	1.4%	–	1.3%
Operating EBIDA	$ 643	$ 124	–	$ 767
Operating EBIDA %	8.0%	1.9%	–	6.0%

Health Services

UPMC Health Services include a comprehensive array of clinical capabilities consisting of hospitals, specialty service lines (e.g., transplantation services, woman care, behavioral health, pediatrics, cancer care and rehabilitation services), contract services (emergency medicine, pharmacy and laboratory) and more than 3,600 employed physicians with associated practices. Also included within Health Services are supporting foundations and UPMC's captive insurance programs. Hospital activity is monitored in four distinct groups: (i) academic hospitals that provide a comprehensive array of clinical services that include the specialty service lines listed above and serve as the primary academic and teaching centers for UPMC and are located in Pittsburgh, Pa.; (ii) community hospitals that provide core clinical services mainly to the suburban Pittsburgh, greater Erie, and the greater Altoona populations of Pennsylvania; (iii) regional hospitals that provide core clinical services to certain other areas of western and central Pennsylvania; and (iv) pre- and post-acute care capabilities that include: UPMC HomeCare, a network of home health services, and UPMC Senior Communities, the facilities of which provide a complete network of senior living capabilities in greater Pittsburgh and surrounding counties. The Health Services division also includes its international ventures which aims to bring new revenue streams into western Pennsylvania. International ventures currently include ISMETT, a transplant and specialty surgery hospital in Palermo, Italy, that has performed more than 1,600 transplants since its founding in 1999, a cancer center located in Ireland, a contract to provide remote second-opinion pathology consultations for patients in China and Singapore, a national oncology treatment and research center in Kazakhstan, as well as the Advanced Radiosurgery Center of Excellence at San Pietro FBF Hospital in Rome.

Health Services revenue of $9.0 billion increased $1.0 billion versus the prior year. Operating income of $105 million decreased by $89 million versus the prior year; prior year operating income benefited from $46 million of interest and favorable adjustment of reserves related to the settlement of the Highmark oncology dispute. The remaining $43 million decrease was driven by expense inflation, payer mix, and increased physician investment, which more than offset payer rate increases and $24 million of operating income due to settlement of a lawsuit with a third party payer.

Insurance Services

UPMC holds various interests in health care financing initiatives and network care delivery operations that have 3.2 million members as of June 30, 2017. UPMC Health Plan is a health maintenance organization ("HMO") offering coverage for commercial and Medicare members. UPMC for You is also an HMO, which is engaged in providing coverage to Medical Assistance & Medicare Special Needs Plan beneficiaries. UPMC Health Network offers preferred provider organization ("PPO") plan designs to serve Medicare beneficiaries. UPMC Health Options offers PPO plan designs to serve commercial beneficiaries. UPMC for Life is a Medicare product line offered by various companies within the Insurance Services division. UPMC Work Partners provides fully insured workers' compensation, and integrated workers' compensation and disability services to employers. Community Care Behavioral Health Organization ("Community Care") is a state-licensed, risk-bearing PPO that manages the behavioral health services for Medical Assistance through mandatory managed care programs in 39 Pennsylvania counties, including Allegheny County.

Insurance Services revenues of $7.2 billion increased $731 million versus the prior year, driven by membership increases of nearly 150,000. Operating income increased by $19 million versus the prior year, as higher underwriting income from membership increases more than offset higher administrative expenses supporting the growth.

UPMC Enterprises

The goal of UPMC Enterprises is to leverage UPMC's integrated delivery and financing system capabilities to generate new revenue streams. This is accomplished by fostering new ideas for improvement in the delivery of health care, pursuing commercialization opportunities of smart technologies and developing strategic partnerships with industry leaders. Leveraging UPMC's long-standing reputation for academic and research excellence, UPMC Enterprises also sponsors the translation of basic science conducted in a research setting to its commercial use in bedside clinical practice, application in medical laboratories, or use across emerging venues where medicine is delivered. These ventures both support UPMC's core mission and help to stimulate the economy of western Pennsylvania.

UPMC Enterprises manages a portfolio that includes various internally-focused initiatives and numerous operating companies with commercially-available products and services directed toward the improvement of the delivery of health care. Unlike the Health Services and Insurance Services divisions, UPMC Enterprises' results are classified as investing and financing activity in the Consolidated statements of operations and changes in net assets, consistent with the long-term nature of developing and commercializing technology-enabled initiatives.

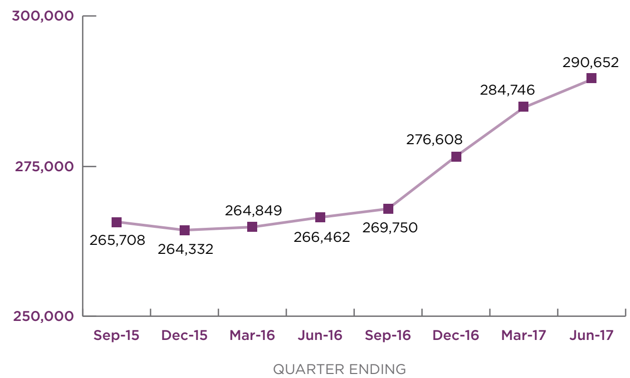
REVENUE METRICS – HEALTH SERVICES

Medical-Surgical Admissions and Observation Visits

Inpatient activity as measured by medical-surgical admissions and observation visits at UPMC's hospitals for the twelve months ended June 30, 2017 increased 9% compared to the same period in 2016.

For the Twelve Months Ended June 30			
(in thousands)	**2017**	Change	2016
Academic	**132.5**	0%	132.5
Community	**89.9**	1%	88.6
Regional	**68.3**	51%	45.3
Regional excl. recent acquisitions	*45.6*	*1%*	*45.3*
Total	**290.7**	9%	266.4
Total excl. recent acquisitions	*268.0*	*1%*	*266.4*

Trailing Twelve-Months

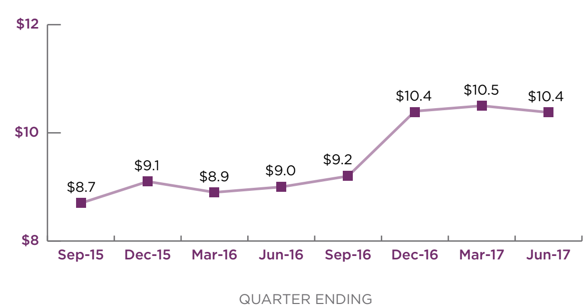


Outpatient Revenue per Workday

UPMC's outpatient activity for the twelve months ended June 30, 2017 as measured by average revenue per workday increased 15% compared to the same period in 2016. Hospital outpatient activity is measured on an equivalent workday ("EWD") basis to adjust for weekend and holiday hours.

For the Twelve Months Ended June 30			
(in thousands)	**2017**	Change	2016
Academic	**$ 5,211**	(0%)	$ 5,236
Community	**2,213**	5%	2,109
Regional	**2,972**	75%	1,703
Regional excl. recent acquisitions	*1,946*	*14%*	*1,703*
Total	**$10,396**	15%	$ 9,048
Total excl. recent acquisitions	*9,370*	*4%*	*9,048*

Quarterly Average (in millions)



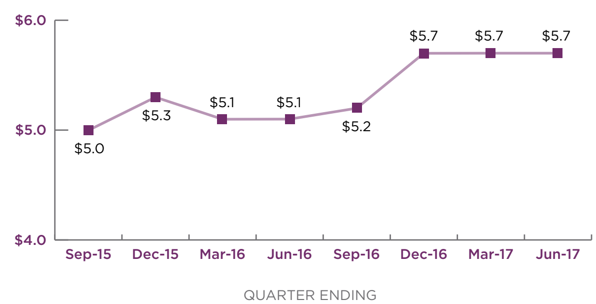
REVENUE METRICS – HEALTH SERVICES (CONTINUED)

Physician Service Revenue per Weekday

UPMC's physician activity for the twelve months ended June 30, 2017 as measured by average revenue per weekday increased 10% from the comparable period in 2016. Physician services activity is measured on a weekday basis.

For the Twelve Months Ended June 30			
(in thousands)	**2017**	Change	2016
Academic	**$ 2,992**	2%	$ 2,937
Community	**2,702**	21%	2,242
Community excl. recent acquisitions	*2,432*	*8%*	*2,242*
Total	**$ 5,694**	10%	$ 5,179
Total excl. recent acquisitions	*5,424*	*5%*	*5,179*

Quarterly Average (in millions)



Sources of Patient Service Revenue

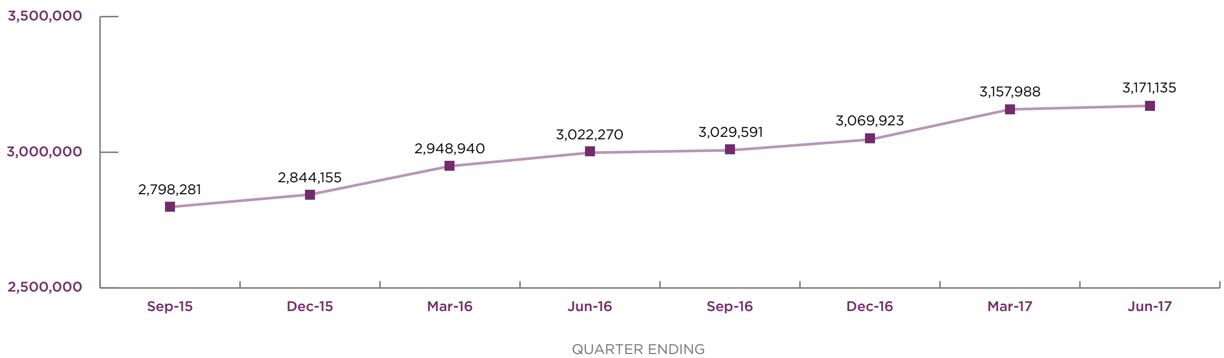
The gross patient service revenues of UPMC are derived from third-party payers which reimburse or pay UPMC for the services it provides to patients covered by such payers. Third-party payers include the federal Medicare Program, the federal and state Medical Assistance Program ("Medicaid"), Highmark Blue Cross Blue Shield ("Highmark") and other third-party insurers such as health maintenance organizations and preferred provider organizations. The following table is a summary of the percentage of the subsidiary hospitals' gross patient service revenue by payer.

	Twelve Months Ended June 30	
	2017	2016
Medicare	**46%**	45%
Medicaid	**18%**	18%
UPMC Insurance Services Commercial	**13%**	12%
National Insurers Commercial	**8%**	9%
Highmark Commercial	**8%**	10%
Other	**7%**	6%
Total	**100%**	100%

OPERATING METRICS - INSURANCE SERVICES

Membership

Membership in the UPMC Insurance Services Division increased to 3,171,135 as of June 30, 2017, a 5% increase versus the same period in the prior year.



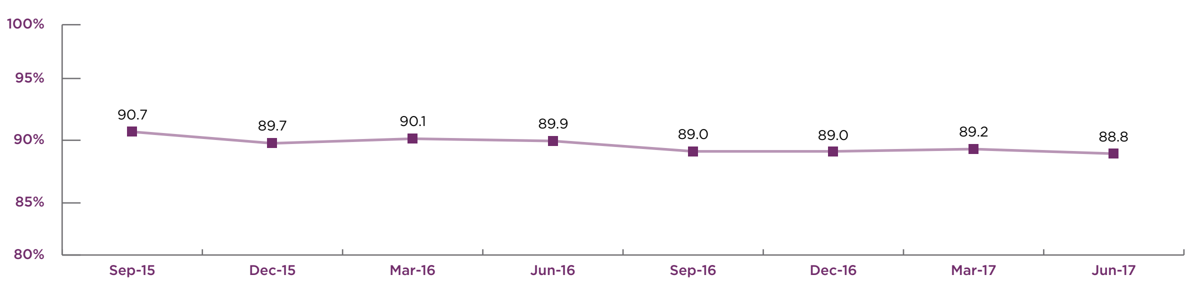
As of	**June 30, 2017**	June 30, 2016*
Commercial Health	**699,107**	625,947
Medicare	**165,353**	155,696
Medicaid	**414,562**	392,281
Sub-Total Physical Health Products	**1,279,022**	1,173,924
Behavioral Health	**985,531**	953,513
Sub-Total Health Products	**2,264,553**	2,127,437
Work Partners and Life Solutions	**467,191**	452,798
Ancillary Products	**340,888**	250,221
Evolent	**98,503**	191,814
Total Membership	**3,171,135**	3,022,270

** Reclassifications were made to prior year categories to conform to current year presentation.*

Medical Expense Ratio

UPMC Insurance Services Medical Expense Ratio remained stable as medical expenses trended consistently with premiums.

Trailing Twelve-Months



KEY FINANCIAL INDICATORS

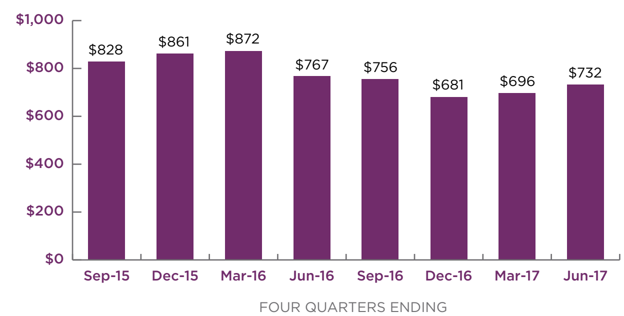
(Dollars in millions)

Operating Earnings before Interest, Depreciation and Amortization

Operating EBIDA for the twelve months ended June 30, 2017 decreased as compared to the twelve months ended June 30, 2016.

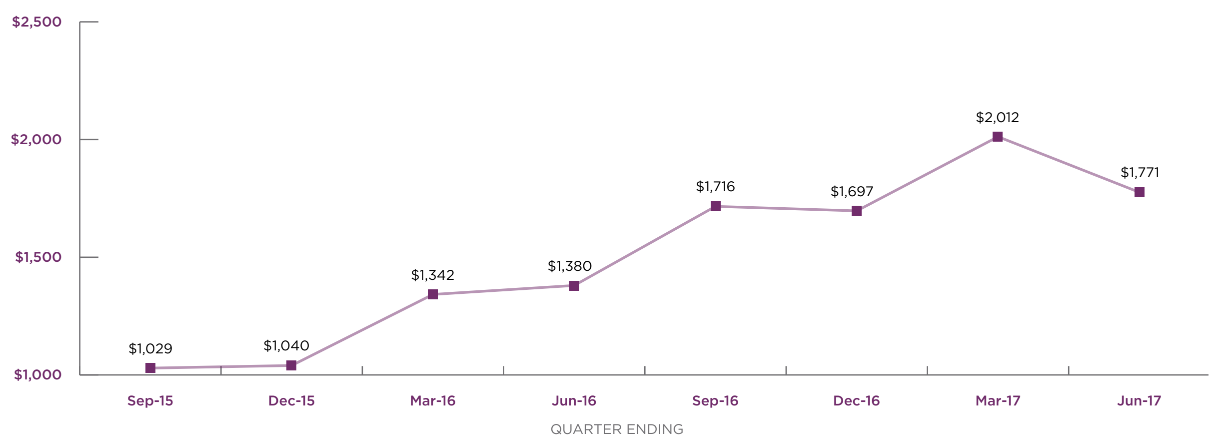
For the Twelve Months Ended June 30	2017	Change	2016
Operating Income	**$ 240**	(23%)	$ 310
Depreciation and Amortization	**492**	8%	457
Operating EBIDA	**$ 732**	(5%)	$ 767

Trailing Twelve Months EBIDA



Unrestricted Cash and Investments Over Long Term Debt

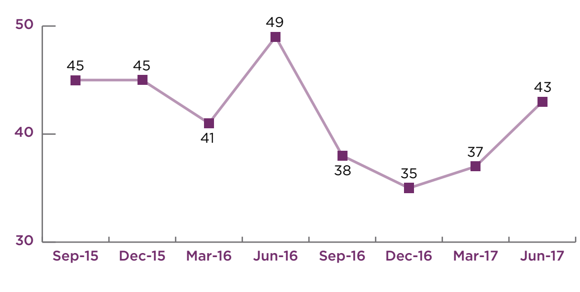
Unrestricted cash over long term debt increased by $391 million as compared to June 2016.



Days in Net Accounts Receivable

Consolidated Days in Accounts Receivable continue to be lower than industry averages due to UPMC's rigorous procedures in this area. Days in Accounts Receivable fluctuations are typically driven by the timing of payment from the state of Pennysylvania's Medicaid program.

By Division as of June 30	2017 Balance	Days	
		2017	2016
Health Services	**$ 1,009**	**44**	49
Insurance Services	**867**	**41**	48
Consolidated	**$ 1,876**	**43**	49

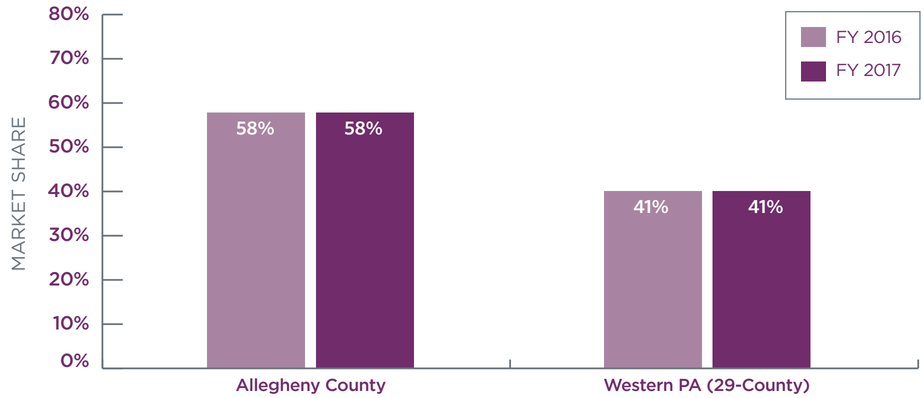


Market Share

The chart below shows the change in UPMC's estimated inpatient market share for the first two quarters of fiscal years 2016 and 2017 (July 1 through December 31st), by service area[1]. This is the most recent market share data currently available.

UPMC INPATIENT MEDICAL-SURGICAL MARKET SHARE

FY16 Q2 YTD VS. FY17 Q2 YTD[2]



(1) UPMC's two service areas are (1) Allegheny County, and (2) a 29-county region which also includes Armstrong, Beaver, Bedford, Blair, Butler, Cambria, Cameron, Centre, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Greene, Huntingdon, Indiana, Jefferson, Lawrence, McKean, Mercer, Potter, Somerset, Venango, Warren, Washington and Westmoreland counties.

(2) Excludes psychiatry and substance abuse discharges.

ASSET AND LIABILITY MANAGEMENT

During the twelve months ended June 30, 2017, UPMC's investment portfolio returned 11.9%. As of June 30, 2017, UPMC utilized 245 ongoing external investment managers including 48 traditional managers, 17 hedge fund managers and 180 private capital managers. UPMC is also invested with an additional 9 legacy private capital managers. UPMC's investment portfolio has a long-term perspective and has generated annualized returns of 11.9%, 4.9% and 7.8% for the trailing one-, three- and five-year periods. As of June 30, 2017, 65% of UPMC's investment portfolio could be liquidated within three days.

UPMC's annualized cost of capital during the period was 3.78%. This cost of capital includes the accrual of interest payments, the amortization of financing costs and original issue discount or premium, the ongoing costs of variable rate debt and the cash flow impact of derivative contracts. As of June 30, 2017, the interest rates on UPMC's long-term debt were approximately 82% fixed and 18% variable after giving effect to derivative contracts. Annualized interest cost for the variable rate debt for the period averaged 1.45%. The annualized interest cost for the fixed rate debt was 4.21%. UPMC has a revolving credit facility which expires in July 2019 and has a borrowing limit of $500 million. As of June 30, 2017, UPMC had approximately $71 million of letters of credit outstanding under the credit facility leaving $429 million available to fund operating and capital needs, of which none was drawn. Recently affiliated entities have revolving credit facilities with borrowing limits of $8 million and had approximately $1 million in letters of credit outstanding leaving $7 million available to fund operating and capital needs, of which none was drawn.

On April 7, 2017, credit facilities of $150 million and $50 million were opened with PNC Bank National Association and Huntington National Bank, respectively, both with expiration dates of April 7, 2022. Both of these credit facilities support the Insurance Services Division. As of June 30, 2017, draws on the PNC Bank National Association and the Huntington National Bank credit facilities were $75 million and $25 million, respectively.

The table below compares reported Investing and Financing Activity for the twelve months ended June 30, 2017 and 2016 by type.

Investing and Financing Activity by Type

Twelve Months Ended June 30	**2017**	2016
(in thousands)		
Realized gains	**$ 296,412**	$ 147,915
Interest and dividends, net of fees	**49,568**	33,638
Realized investment revenue	**$ 345,980**	$ 181,553
Unrealized gains on derivative contracts	**2,104**	4,558
Other unrealized gains (losses)	**247,965**	(141,022)
Impairment on cost basis investments	**(24,399)**	(12,679)
Investment revenue	**$ 571,650**	$ 32,410
Interest expense	**(127,235)**	(114,634)
Loss on extinguishment of debt	**(53)**	(54)
UPMC Enterprises results, net	**(142,470)**	(71,136)
Gain (loss) from investing and financing activities	**$ 301,892**	$ (153,414)

Sources and Uses of Cash

UPMC's primary source of operating cash is the collection of revenues and related accounts receivable. As of June 30, 2017, UPMC had approximately $673 million of cash and cash equivalents on hand to fund operations and capital expenditures, and borrowing availability under its credit facilities was $708 million, of which $172 million was drawn.

Operating EBIDA was $732 million for the twelve months ended June 30, 2017, compared to $767 million for the twelve months ended June 30, 2016. Net cash provided by operating activities was $537 million for the twelve months ended June 30, 2017 compared to $552 million for the twelve months ended June 30, 2016.

Key sources and uses of cash from investing activities for the year ended June 30, 2017 include capital expenditures of $548 million, as well as $41 million to acquire ownership interests in and fund businesses. Major capital projects included construction and improvements on the UPMC Presbyterian South Tower and UPMC Altoona - Logan Medical Center. Major Information Services projects included enhancements that are advancing UPMC's leading clinician centric computing environment, technology infrastructure that supports UPMC's diversified digital environment, investments in enterprise data analytics and other technologies that are transforming the consumer experience across the spectrum of health care.

Additionally, in the twelve months ended June 30, 2017, contributions to the defined benefit pension plan of $262 million were made to maintain its funded status and to avoid paying excess premiums to the Pension Benefit Guaranty Corporation ("PBGC").

UTILIZATION STATISTICS

PERIOD ENDED JUNE 30, 2017

The following table, presents selected consolidated statistical indicators of medical-surgical, psychiatric, sub-acute and rehabilitation patient activity for the twelve months ended June 30, 2017 and 2016.

	Twelve Months Ended June 30	
	2017	2016*
Licensed Beds	**6,992**	5,864
BEDS IN SERVICE		
Medical-Surgical	**3,986**	3,674
Psychiatric	**437**	410
Rehabilitation	**257**	201
Skilled Nursing	**1,219**	877
Total Beds in Service	**5,899**	5,162
PATIENT DAYS		
Medical-Surgical	**1,056,810**	961,594
Psychiatric	**131,253**	128,168
Rehabilitation	**72,750**	63,611
Skilled Nursing	**339,868**	249,236
Total Patient Days	**1,600,681**	1,402,609
Average Daily Census	**4,385**	3,832
Observation Days	**105,758**	100,278
Obs Average Daily Census	**290**	274
ADMISSIONS AND OBSERVATION CASES		
Medical-Surgical	**208,311**	188,481
Observation Cases	**82,341**	77,981
Subtotal	**290,652**	266,462
Psychiatric	**11,796**	10,718
Rehabilitation	**4,969**	4,410
Skilled Nursing	**4,846**	4,248
Total Admissions and Observation Cases	**312,263**	285,838
Overall Occupancy	**79%**	80%
AVERAGE LENGTH OF STAY		
Medical-Surgical	**5.1**	5.1
Psychiatric	**11.1**	12.0
Rehabilitation	**14.6**	14.4
Skilled Nursing	**70.1**	58.7
Overall Average Length of Stay	**7.0**	6.7
Emergency Room Visits	**839,135**	723,954
TRANSPLANTS (PITTSBURGH)		
Liver	**145**	106
Kidney	**227**	214
All Other	**296**	343
Total	**668**	663
OTHER POST-ACUTE METRICS		
Home Health Visits	**732,982**	718,800
Hospice Care Days	**190,964**	117,561
Outpatient Rehab Visits (CRS)	**626,562**	574,219

** Prior year was updated to include certain skilled nursing statistics that were previously excluded to conform to current year presentation.*

OUTSTANDING DEBT

PERIOD ENDED JUNE 30, 2017
(IN THOUSANDS)

Issuer	Original Borrower	Series	Amount Outstanding
Allegheny County Hospital Development Authority	UPMC Health System	1997B	$ 43,546
	UPMC	2007A	73,764
	UPMC	2007B	64,602
	UPMC	2008A	65,854
	UPMC	2008B	105,453
	UPMC	2008 Notes	83,906
	UPMC	2009A	332,543
	UPMC	2010A	122,666
	UPMC	2010B	97,888
	UPMC	2010C	50,000
	UPMC	2010D	150,000
	UPMC	2010F	95,000
	UPMC	2011A	86,551
Monroeville Finance Authority	UPMC	2012	343,373
	UPMC	2013B	67,336
	UPMC	2014B	49,691
	UPMC	2015A Note	67,767
Pennsylvania Economic Development Financing Authority	UPMC	2013A	119,429
	UPMC	2014A	314,994
	UPMC	2015B	127,499
	UPMC	2016	269,502
Erie County Hospital Authority	Hamot Health Foundation	2007	29,570
	Hamot Health Foundation	2010A	12,461
	Hamot Health Foundation	2010C	1,420
Pennsylvania Higher Educational Facilities Authority	UPMC	2010E	226,037
Lycoming County Authority	Susquehanna Health System	2009	146,472
	The Williamsport Hospital	2011	17,149
Tioga County Industrial Development Authority	Laurel Health System	2002	449
	Laurel Health System	2010	8,046
	Laurel Health System	2011	6,232
None	UPMC	2011B	99,435
	Susquehanna Health Innovation Center	New Market Tax Credit	16,791
	UPMC/Susquehanna Health System	Swap Liabilities	10,709
	Various - Capital Leases and Loans		59,600
Total			**$ 3,365,735**

Includes original issue discount and premium, deferred financing costs, and other.

Source: UPMC Records

DEBT COVENANT CALCULATIONS

PERIOD ENDED JUNE 30, 2017

DEBT SERVICE COVERAGE RATIO

(Dollars in Thousands)

	Trailing Twelve-Month Period Ended June 30, 2017
Net Income	$ 990,538
ADJUSTED BY:	
Net Unrealized Losses from Period [1]	(184,792)
Depreciation and Amortization [1]	491,907
Loss on Defeasance of Debt [1]	53
Inherent Contribution [1]	(453,755)
Other Non-operating Income [2]	(524)
Realized Investment Impairments [2]	(2,922)
Interest Expense	126,313
Revenues Available for Debt Service	$ 966,818
Historical Debt Service Requirements – 2007 MTI	$ 272,172
Debt Service Coverage Ratio – 2007 MTI	**3.55X**
Historical Debt Service Requirements – All Debt and Leases	$ 291,314
Debt Service Coverage Ratio – All Debt and Leases	**3.32X**

LIQUIDITY RATIO AS OF JUNE 30, 2017

Unrestricted Cash and Investments	$ 5,018,710
Master Trust Indenture Debt	$ 3,200,336
Unrestricted Cash to MTI Debt	**1.57**

(1) Non-Cash.

(2) Reflects ultimate realization of previously impaired cost-based investments.

I hereby certify to the best of my knowledge that, as of June 30, 2017, UPMC is in compliance with the applicable covenants contained in the financing documents for the bonds listed on the cover hereof and all applicable bank lines of credit and no Event of Default (as defined in any related financing document) has occurred and is continuing.

C. Talbot Heppenstall, Jr.
Treasurer
UPMC

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
UPMC
Pittsburgh, Pennsylvania

We have audited the accompanying consolidated balance sheets of UPMC and subsidiaries as of June 30, 2017 and 2016, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of UPMC and subsidiaries at June 30, 2017 and 2016, 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.

We also have audited, in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America, UPMC's internal control over financial reporting as of June 30,2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated August 29, 2017 expressed an unqualified opinion thereon.

Ernst & Young LLP

August 29, 2017

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

	June 30 2017	2016
CURRENT ASSETS		
Cash and cash equivalents	**$ 673,447**	$ 431,471
Patient accounts receivable, net of allowance for uncollectable accounts of $153,227 at June 30, 2017 and $119,943 at June 30, 2016	**830,817**	699,024
Other receivables	**1,050,394**	1,079,175
Other current assets	**201,016**	165,587
Total current assets	**2,755,674**	2,375,257
Board-designated, restricted, trusteed and other investments	**5,277,208**	4,664,932
Beneficial interests in foundations and trusts	**493,322**	442,552
Property, buildings and equipment:		
Land and land improvements	**401,445**	361,679
Buildings and fixed equipment	**5,539,368**	5,029,854
Movable equipment	**2,972,704**	2,477,082
Capital leases	**104,338**	104,515
Construction in progress	**208,155**	183,000
	9,226,010	8,156,130
Less allowance for depreciation	**(5,129,958)**	(4,542,356)
	4,096,052	3,613,774
Other assets	**366,276**	365,897
Total assets	**$ 12,988,532**	$ 11,462,412
CURRENT LIABILITIES		
Accounts payable and accrued expenses	**$ 505,443**	$ 473,885
Accrued salaries and related benefits	**651,226**	627,802
Current portion of insurance reserves	**488,138**	522,941
Current portion of long-term obligations	**367,235**	158,718
Other current liabilities	**714,287**	452,841
Total current liabilities	**2,726,329**	2,236,187
Long-term obligations	**2,998,500**	2,904,158
Pension liability	**89,482**	397,691
Long-term insurance reserves	**306,957**	284,938
Other noncurrent liabilities	**212,239**	214,676
Total liabilities	**6,333,507**	6,037,650
Unrestricted net assets	**5,935,672**	4,801,607
Restricted net assets	**719,353**	623,155
Total net assets	**6,655,025**	5,424,762
Total liabilities and net assets	**$ 12,988,532**	$ 11,462,412

See accompanying notes

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

(IN THOUSANDS)

	Twelve Months Ended June 30	
	2017	2016
UNRESTRICTED NET ASSETS		
Net patient service revenue:		
Patient service revenue (net of contractual allowances and discounts)	**$ 6,652,610**	$ 5,896,940
Provision for bad debts	**(306,357)**	(228,043)
Net patient service revenue less provision for bad debts	**6,346,253**	5,668,897
Insurance enrollment revenue	**6,811,082**	6,141,444
Other revenue	**1,189,494**	1,037,762
Total operating revenues	**14,346,829**	12,848,103
Expenses:		
Salaries, professional fees and employee benefits	**5,155,147**	4,553,472
Insurance claims expense	**4,416,959**	3,995,892
Supplies, purchased services and general	**4,042,452**	3,531,250
Depreciation and amortization	**491,907**	457,435
Total operating expenses	**14,106,465**	12,538,049
Operating income	**240,364**	310,054
Inherent contribution	**453,755**	2,660
Other non-operating expense	**(522)**	-
Income tax expense	**(4,951)**	(24,914)
After-tax income	**$ 688,646**	$ 287,800
Investing and financing activities:		
Investment revenue	**571,650**	32,410
Interest expense	**(127,235)**	(114,634)
Loss on extinguishment of debt	**(53)**	(54)
UPMC Enterprises activity:		
Portfolio company revenue	**25,066**	8,252
Portfolio company and development expense	**(167,536)**	(79,388)
Gain (loss) from investing and financing activities	**301,892**	(153,414)
Excess of revenues over expenses	**990,538**	134,386
Other changes in unrestricted net assets	**143,527**	(122,067)
Change in unrestricted net assets	**1,134,065**	12,319
RESTRICTED NET ASSETS		
Contributions and other changes	**3,914**	3,441
Net realized and unrealized gains on restricted investments	**11,983**	204
Restricted net assets acquired	**52,114**	-
Assets released from restriction for operations and capital purchases	**(9,885)**	(18,446)
Change in beneficial interest	**38,072**	(13,852)
Change in restricted net assets	**96,198**	(28,653)
Change in net assets	**1,230,263**	(16,334)
Net assets, beginning of period	**5,424,762**	5,441,096
Net assets, end of period	**$ 6,655,025**	$ 5,424,762

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	Twelve Months Ended June 30	
	2017	2016
OPERATING ACTIVITIES		
Change in net assets	**$ 1,230,263**	$ (16,334)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	**491,907**	457,435
Provision for bad debts	**306,357**	228,043
Change in beneficial interest in foundations	**(38,072)**	13,852
Change in pension liability	**(349,819)**	158,841
Restricted contributions and investment revenue	**(15,897)**	(3,645)
Restricted net assets acquired through affiliations	**(52,114)**	-
Unrealized losses on investments	**(223,566)**	141,022
Realized gains on investments	**(345,980)**	(181,553)
Sales of non-alternative investments	**4,213,287**	2,700,676
Purchases of non-alternative investments	**(4,019,299)**	(2,793,163)
Inherent contribution	**(453,755)**	-
Intangible impairment charge	**59,081**	-
Changes in operating assets and liabilities:		
Accounts receivable	**(324,072)**	(313,998)
Other current assets	**(15,035)**	(9,254)
Accounts payable and accrued liabilities	**(36,274)**	39,526
Insurance reserves	**(12,784)**	45,899
Other current liabilities	**176,967**	83,765
Other noncurrent assets	**(21,782)**	51,674
Other operating changes	**(32,172)**	(50,988)
Net cash provided by operating activities	**537,241**	551,798
INVESTING ACTIVITIES		
Purchase of property and equipment, net of disposals	**(537,352)**	(381,350)
Investments in joint ventures	**(41,000)**	(67,000)
Cash acquired as part of affiliations	**67,507**	(16,616)
Change in investments designated as nontrading	**7,675**	9,134
Sales of alternative investments	**235,691**	305,748
Purchases of alternative investments	**(184,797)**	(203,799)
Change in other assets	**9,549**	7,583
Net cash used in investing activities	**(442,727)**	(346,300)
FINANCING ACTIVITIES		
Repayments of long-term obligations	**(240,920)**	(214,899)
Borrowings of long-term obligations	**372,485**	146,936
Restricted contributions and investment income	**15,897**	3,645
Net cash provided by (used in) financing activities	**147,462**	(64,318)
Net change in cash and cash equivalents	**241,976**	141,180
Cash and cash equivalents, beginning of period	**431,471**	290,291
Cash and cash equivalents, end of period	**$ 673,447**	$ 431,471
SUPPLEMENTAL INFORMATION		
Capital lease obligations incurred to acquire assets	**$ 10,691**	$ 2,989

(IN THOUSANDS)

1. ORGANIZATIONAL OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

UPMC is a Pennsylvania nonprofit corporation and is exempt from federal income tax pursuant to Section 501(a) of the Internal Revenue Code ("Code") as an organization described in Section 501(c)(3) of the Code. Headquartered in Pittsburgh, Pennsylvania, UPMC is one of the leading integrated delivery and financing systems in the United States. UPMC is an integrated global health enterprise leveraging medical expertise, geographic reach, and financial stability in a model of care excellence that can transform health care nationally and internationally. UPMC comprises nonprofit and for-profit entities offering medical and health care related services, including health insurance products. Closely affiliated with the University of Pittsburgh ("University") and with shared academic and research objectives, UPMC partners with the University's Schools of the Health Sciences to deliver outstanding patient care, train tomorrow's health care specialists and biomedical scientists, and conduct groundbreaking research on the causes and course of disease.

The accompanying consolidated financial statements include the accounts of UPMC and its subsidiaries. The consolidated financial statements are comprised of domestic and foreign nonprofit and for-profit entities that maintain separate books and records as part of their legal incorporation. Intercompany accounts and transactions are eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and investments, which are so near to maturity (maturity of three months or less when purchased) that they present insignificant risk of changes in value.

Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported at estimated net realizable amounts in the period in which services are provided. The majority of UPMC's services are rendered to patients under Medicare, Highmark Blue Cross Blue Shield ("Highmark"), Medical Assistance programs, national payers and UPMC Insurance Services. Reimbursement under these programs is based on a combination of prospectively determined rates, discounted charges and historical costs. Amounts received under Medicare and Medical Assistance programs are subject to review and final determination by program intermediaries or their agents. Reimbursement by UPMC Insurance Services to UPMC providers is eliminated in consolidation and therefore excluded from the tables below.

For the years ended June 30, 2017 and 2016, the percentage of patient service revenue, net of contractual allowances and discounts, derived from third-party payers and self-pay patients is as follows:

	June 30	
Year Ended	**2017**	2016
Third party	**93%**	94%
Self-pay	**7%**	6%
	100%	100%

In 2017 and 2016, the percentage of net patient service revenue derived from Medicare, Highmark, Medical Assistance, and national payers, is as follows:

	June 30	
Year Ended	**2017**	2016
Medicare	**35%**	34%
Highmark	**16%**	18%
National payers	**15%**	16%
Medical Assistance	**12%**	13%

(IN THOUSANDS)

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

Provisions for adjustments to net patient service revenue are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Net patient service revenue for 2017 and 2016 was increased by approximately $31,588 and $19,837, respectively, resulting from prior-year settlements.

The provision for bad debts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. UPMC records a provision for bad debts in the period services are provided related to self-pay patients, including both uninsured patients and patients with deductible and copayment balances due for which third-party coverage exists for a portion of their balance. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience and expected net collections. The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for uncollectible accounts. Provisions for bad debts increased to $153,227 as of June 30, 2017, from $119,943 as of June 30, 2016, primarily as a result of affiliations noted in Note 2. Concentrations of net patient accounts receivable at June 30, 2017 and 2016, primarily resulting from patients centered in the western Pennsylvania region include:

	June 30	
Year Ended	**2017**	2016
Medicare	**23%**	20%
Highmark	**21%**	23%
National payers	**17%**	20%
Medical Assistance	**11%**	8%

Other Receivables

Other receivables are primarily comprised of payments due to the Insurance Services division and include the uncollected amounts from fully-insured groups, individuals and government programs and are reported net of an allowance for estimated terminations and uncollectible accounts.

Board-Designated, Restricted, Trusteed, and Other Investments

Substantially all of UPMC's investments in debt and equity securities are classified as trading. This classification requires UPMC to recognize unrealized gains and losses on substantially all of its investments in debt and equity securities as investment revenue in the consolidated statements of operations and changes in net assets. UPMC's investments in debt and equity securities that are donor-restricted assets are designated as nontrading. This classification also includes UPMC Enterprises' cost basis investments in early stage entities, which are categorized as alternative investments. Unrealized gains and losses on donor-restricted assets are recorded as changes in restricted net assets in the consolidated statements of operations and changes in net assets. Gains and losses on the sales of securities are determined by the average cost method. Realized gains and losses are included in investment revenue in the consolidated statements of operations and changes in net assets.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations. These investments predominantly include those maintained in Master Trust Funds ("MTF") and are summarized as nonalternative investments in Note 4.

Investments in limited partnerships that invest in marketable securities (hedge funds) are reported using the equity method of accounting based on information provided by the respective partnership. The values provided by the respective partnerships are based on historical cost, appraisals, or other estimates that require varying degrees of judgment. Generally, UPMC's holdings reflect net contributions to the partnership and an allocated share of realized and unrealized investment income and expenses. The investments may individually expose UPMC to securities lending, short sales, and trading in futures and forward contract options and other derivative products. UPMC's risk is limited to its carrying value for these lending and derivatives transactions. Amounts can be divested only at specified times. The financial statements of the limited partnerships are audited annually, generally as of December 31. These investments are summarized as alternative investments in Note 4.

Investments in limited partnerships that invest in nonmarketable securities (private equity) are primarily recorded at cost if the ownership percentage is less than 5% and are reported using the equity method of accounting if the ownership percentage is greater than 5%. These investments are periodically evaluated for impairment. These investments are summarized as alternative investments in Note 4.

Fair Value Elections

Pursuant to accounting guidance provided by Accounting Standards Codification ("ASC") 825-10, *Financial Instruments*, UPMC makes elections, on an investment-by-investment basis, as to whether it measures certain equity method investments that are traded in active markets at fair value. Fair value elections are generally irrevocable. The initial unrealized gains recognized upon election of the fair value option are recorded as operating revenue in the consolidated statements of operations and changes in net assets consistent with accounting for other equity method investments where UPMC has the ability to exercise significant influence but not control. Any subsequent changes in the fair value of the investment are recorded as investment revenue in the consolidated statements of operations and changes in net assets consistent with UPMC's reporting of gains and losses on other marketable securities included in board-designated, restricted, trusteed, and other investments. Management believes this reporting increases the transparency of UPMC's financial condition.

Financial Instruments

Cash and cash equivalents and investments recorded at fair value aggregate $4,357,535 and $3,520,135 at June 30, 2017 and 2016, respectively. The fair value of these instruments is based on market prices as estimated by financial institutions. The fair value of long-term debt at June 30, 2017 and 2016, is $3,471,318 and $3,275,982, respectively, based on market prices as estimated by financial institutions which would be categorized as Level 2 if presented in the fair value table found in footnote 7. The fair value of amounts owed to counterparties under derivative contracts at June 30, 2017 and 2016, is $10,709 and $18,120, respectively, and due from counterparties is $343 and $5,647, respectively, based on pricing models that take into account the present value of estimated future cash flows.

Beneficial Interests in Foundations and Trusts

Several of UPMC's subsidiary hospitals have foundations that, according to their bylaws, were formed for the exclusive purpose of supporting and furthering the mission of the respective hospital. The foundations are separate corporations and are not liable for the obligations of UPMC, including any claims of creditors of any UPMC entities. The net assets of certain foundations are included in the consolidated balance sheets as beneficial interests in foundations and restricted net assets because the hospitals' use of these assets is at the discretion of the foundations' independent boards of directors.

Beneficial interests in foundations and trusts of $493,322 and $442,552 and the net assets of consolidated foundations of $104,959 and $62,022 as of June 30, 2017 and 2016, respectively, are not pledged as collateral for UPMC's debt.

Property, Buildings, and Equipment

Property, buildings, and equipment are recorded at cost or, if donated or impaired, at fair market value at the date of receipt or impairment. Interest cost incurred on borrowed funds (net of interest earned on such funds) during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Costs associated with the development and installation of internal-use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post-implementation stage.

Depreciation is computed using the straight-line method at rates designed to depreciate the assets over their estimated useful lives (predominantly ranging from 3 to 40 years) and includes depreciation related to capitalized leases. Certain newly constructed buildings have estimated useful lives up to 60 years. Depreciation expense on property, buildings, and equipment for years ended June 30, 2017 and 2016 was $490,985 and $456,906, respectively.

Asset Impairment

UPMC evaluates the recoverability of the carrying value of long-lived assets by reviewing long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and adjusts the asset cost to fair value if undiscounted cash flows are less than the carrying amount of the asset. There have been no significant impairments in the years ended June 30, 2017 and 2016.

Other Assets

Investments in individual entities in which UPMC has the ability to exercise significant influence but does not control, generally 20% to 50% ownership, are reported using the equity method of accounting unless the fair value option is elected. All other noncontrolled investments, generally less than 20% ownership, are carried at cost. Other assets include approximately $105,204 and $100,781 at June 30, 2017 and 2016, respectively, relating to investments in partnerships/joint ventures that provide health care, management, and other goods and services to UPMC, its affiliates, and the community at large.

Goodwill

Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to the fair value of assets acquired and liabilities assumed. As of June 30, 2017 and 2016, goodwill of $155,448 and $120,839, respectively, is recorded in UPMC's consolidated balance sheets as other assets. Changes in goodwill since the prior year include the addition of $16,862 related to the acquisition of RxAnte, an early stage company within the UPMC Enterprises division. Additionally, $12,649 of additional goodwill related to the prior year affiliation with Jameson Health System was recorded as purchase accounting was finalized. Other immaterial additions of goodwill totaling $5,098 were recorded during the course of the year.

Goodwill is reviewed annually for impairment, or more frequently if events or circumstances indicate that the carrying value of an asset may not be recoverable. In connection with changes in accounting standards, which were adopted by UPMC in 2012, UPMC has the option to qualitatively assess goodwill for impairment before completing a quantitative assessment. Under the qualitative approach, if, after assessing the totality of events or circumstances, including both macroeconomic, industry and market factors, and entity-specific factors, UPMC determines it is likely (more likely than not) that the fair value is greater than its carrying amount, then the quantitative impairment analysis is not required. As of June 30, 2017, after application of the qualitative approach, there were no indicators of impairment.

Derivatives

UPMC uses derivative financial instruments ("derivatives") to modify the interest rates and manage risks associated with its asset allocation and outstanding debt. UPMC records derivatives as assets or liabilities in the consolidated balance sheets at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. UPMC has entered into interest rate swap agreements that convert a portion of its variable rate debt to a fixed interest rate. UPMC has also entered into equity-related derivatives to manage the asset allocation in its investment portfolio. Under the equity index swap agreements, UPMC pays a fixed income-like return in order to receive an equity-like return. The notional amount of these swaps is based upon UPMC's target asset allocation. None of UPMC's swaps outstanding as of June 30, 2017 and 2016, are designated as hedging instruments and, as such, changes in fair value are recognized in investing and financing activities as investment revenue in the consolidated statements of operations and changes in net assets.

By using derivatives to manage these risks, UPMC exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivatives. When the fair value of a derivative is positive, the counterparty owes UPMC, which creates credit risk for UPMC. When the fair value of a derivative is negative, UPMC owes the counterparty, and therefore, it does not incur credit risk. UPMC minimizes the credit risk in derivatives by entering into transactions that require the counterparty to post collateral for the benefit of UPMC based on the credit rating of the counterparty and the fair value of the derivative. If UPMC has a derivative in a liability position, UPMC's credit is a risk and fair market values could be adjusted downward. Market risk is the effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of derivative positions in the context of UPMC's total blended cost of capital.

Net Assets

Resources are classified for reporting purposes as unrestricted, temporarily restricted, or permanently restricted, according to the absence or existence of donor-imposed restrictions. Board-designated net assets are unrestricted net assets that have been set aside by the Board for specific purposes. Temporarily restricted assets are those assets, including contributions and accumulated investment returns, whose use has been limited by donors for a specific purpose or time period. Permanently restricted net assets are those for which donors require the principal of the gifts to be maintained in perpetuity to provide a permanent source of income.

Restricted net assets include $274,217 and $250,814 of permanently restricted net assets held in perpetuity at June 30, 2017 and 2016, respectively. The remainder of restricted net assets is temporarily restricted and primarily represents beneficial interests in foundations that support research and other health care programs. Temporarily restricted net assets are limited by donors and the foundations to a specific time period or purpose. Temporarily restricted net assets are reclassified to unrestricted net assets and included in the consolidated statements of operations and changes in net assets as other revenue or assets released from restriction for capital purchases when the restriction is met.

Excess of Revenues Over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses as a performance indicator. Excess of revenues over expenses includes all changes in unrestricted net assets except for contributions and distributions from foundations for the purchase of property and equipment, adjustments for pension liability, other than net periodic pension cost, discontinued operations if any, and the cumulative effect of changes in accounting principles if any.

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 and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*, which will replace most existing revenue recognition guidance in U.S. GAAP and is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. The core principle of ASU 2014-09 is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASU2014-09 also requires additional disclosures about the nature, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. ASU 2014-09 allows for either retrospective or modified retrospective methods of adoption and is effective for periods beginning after December 15, 2017, upon the FASB's decision to delay the effective date by one year. In preparation for the adoption of the new standard, UPMC continues to evaluate and refine its estimates of the anticipated impacts it will have on policies, procedures, financial position, results of operations, cash flows, financial disclosures and control framework. UPMC has elected the modified retrospective application for the adoption of the guidance. Additionally, UPMC does anticipate that the majority of its provision for bad debts related to its self-pay patient population will be recognized as a direct reduction to revenues as a pricing concession, instead of separately as a deduction to arrive at net patient service revenue. UPMC expects to adopt the new standard using the modified retrospective application, and does not currently believe the adoption will have a significant impact on our recognition of net revenues or related disclosures for any period.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 requires that all costs incurred to issue debt be presented as a direct deduction from the carrying value of debt. Previous standards required these costs to be shown as a deferred charge (i.e., an asset). There is no change as to the presentation or method of amortizing these costs to the consolidated statements of operations and changes in net assets. The adoption of ASU 2015-03 resulted in a decrease in both Other assets and Long-term obligations of $25,745 and $22,128 as of June 30, 2017 and 2016, respectively.

In May 2015, the FASB issued ASU 2015-09, *Disclosures about Short-Duration Contracts*, that require entities to make additional disclosures about short-duration contracts for health insurance. The disclosures focus on the liability for unpaid claims and claim adjustment expenses. The guidance is effective for annual periods beginning after December 15, 2016 and interim periods within annual periods beginning after December 15, 2017. The adoption of this update is not expected to have a material effect on the financial statements, results of operations or liquidity of UPMC.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations* (Topic 805): *Simplifying the Accounting for Measurement-Period Adjustments*. This standard requires that adjustments made to provisional amounts recognized in a business combination be recorded in the period such adjustments are determined, rather than retrospectively adjusting previously reported amounts. ASU 2015-16 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, and early adoption is permitted. UPMC adopted ASU 2015-16 during the first quarter of fiscal year 2016, and there was no impact to the consolidated financial statements. UPMC will apply the new guidance to future adjustments to provisional amounts.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments*, that will require entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in excess of revenues over expenses unless the investments qualify for the new practicability exception. The guidance is effective for periods beginning in 2018. UPMC is assessing the overall impact this update will have on its financial statements, results of operations and liquidity.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires lessees to recognize assets and liabilities arising from operating leases on the statement of financial position and to disclose key information about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Early adoption is permitted. UPMC anticipates that the adoption of ASU 2016-02 will result in an increase in both assets and liabilities reflected on the balance sheet. UPMC will continue evaluating the impact the adoption of ASU 2016- 02 will have on its consolidated financial statements and will update disclosures accordingly.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not- For-Profit Entities*, which will require not-for-profit entities to revise financial presentation to include: net asset classifications, provide quantitative and qualitative information as to available resources and management of liquidity and liquidity risk, information on investment expenses and returns, and the presentation of operating cash flows. The standard aims to help the reader of the financial statements to better understand the financial position of the organization and enhance consistency among similar organizations. ASU 2016-02 is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. UPMC is currently evaluating the impact that the adoption of ASU 2016-14 will have on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This new guidance requires the disaggregation of the service cost component from the other components of net benefit cost. The service cost component of net benefit cost is to be reported in the same line item on the consolidated statement of operations as other compensation costs arising from services rendered by the pertinent employees, while the other components of net benefit cost are to be presented in the consolidated statement of operations separately, outside a subtotal of operating income. The amendments also provide explicit guidance to allow only the service cost component of net benefit cost to be eligible for capitalization. This new guidance is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019, with the adoption of the change in presentation of net benefit cost in the consolidated statement of operations to be applied retrospectively, and the change in capitalization for only service cost applied prospectively. The guidance allows a practical expedient that permits the use of the amounts disclosed in the retirement benefits footnote for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements. UPMC is assessing the overall impact this guidance will have on its consolidated financial statements.

2. SIGNIFICANT TRANSACTIONS

On October 1, 2016, UPMC and Susquehanna Health System ("Susquehanna"), executed an Integration and Affiliation Agreement (the "Agreement") providing for an affiliation between UPMC and Susquehanna. Susquehanna is a multi-institutional nonprofit health system that includes hospitals and a network of other health care providers servicing Lycoming County and a larger multicounty area in central Pennsylvania. The transaction is intended to preserve and enhance the mission of Susquehanna and to enhance Susquehanna's ability to provide high-quality health services to its service area. On the date of the affiliation, the articles of incorporation and bylaws of Susquehanna were amended such that UPMC became the sole corporate member of Susquehanna.

As a result of the affiliation, UPMC acquired approximately $823,000 of total assets, consisting of $381,000 of property, plant and equipment, $328,000 of cash and investments, $44,000 of current and long-term assets and $70,000 of accounts receivable, assumed approximately $332,000 of Susquehanna's liabilities, including $222,000 of long-term debt obligations and current and long-term liabilities of $110,000, and acquired approximately $38,000 of restricted net assets. Pursuant to the Agreement, UPMC will provide Susquehanna with a total investment of $500,000 to expand healthcare services, maintain its patient-focused mission, invest in information technology, and introduce to the region more choice for health insurance.

On December 1, 2016, UPMC and WCA Health System ("WCA"), executed an Integration and Affiliation Agreement (the "Agreement") providing for an affiliation between UPMC and WCA. WCA is a multi-institutional nonprofit health system servicing the Jamestown region of western New York. The transaction is intended to preserve and enhance the mission of WCA and to enhance WCA's ability to provide high-quality health services to its service area. On the date of the affiliation, the articles of incorporation and bylaws of WCA were amended such that UPMC became the sole corporate member of WCA.

As a result of the affiliation, UPMC acquired approximately $85,000 of total assets, consisting of $38,000 of property, plant and equipment, $26,000 of cash and investments, $9,000 of current and long-term assets and $12,000 of accounts receivable, and assumed approximately $75,000 of WCA's liabilities including $27,000 of long-term debt obligations and current and long-term liabilities of $48,000. Pursuant to the Agreement, UPMC will provide WCA with a total investment of $25,000 to continue supporting improved care coordination and delivery of services, assisting with recruitment and retention of outstanding physicians, and upgrading facilities, programs, and infrastructure, including information technology.

The purchase accounting is preliminary and subject to the completion of the fair value assessment of the acquired fixed assets, current and long term assets and liabilities, and any identified intangible assets. In valuing these assets and liabilities, fair values are based on, but not limited to, independent appraisals, discounted cash flows, replacement costs and actuarially determined values. Material adjustments, if any, to provisional amounts in subsequent periods, will be reflected as required.

For these affiliations, UPMC applied the not-for-profit business combination accounting guidance. The guidance primarily characterizes business combinations between not-for-profit entities as nonreciprocal transfers of assets resulting in the contribution of the acquiree's net assets to the acquirer. The guidance prescribes that the acquirer recognize an excess of the acquisition date fair value of unrestricted net assets acquired over the fair value of the consideration transferred as a separate credit in its statement of operations as of the acquisition date or conversely, recognize the excess of the fair value of the consideration transferred over the fair value of the unrestricted net assets acquired as goodwill. Accordingly, UPMC recognized an inherent contribution related to the unrestricted net assets acquired in the Susquehanna transaction of $453,755 in its statements of operations and changes in net assets for the year ended June 30, 2017. The inherent contribution income recorded for the period is based on the preliminary fair market values of the unrestricted net assets acquired.

If Susquehanna and WCA had been consolidated for the entire year, an additional $188,330 of net patient service revenue would have been recognized for the year ended June 30, 2017, as well as an additional $2,926 of excess of revenues over expenses for the year ended June 30, 2017. For the portion of the year in which these entities were consolidated, UPMC recognized net patient service revenues of $501,999 and excess of revenues over expenses of $24,965. If Susquehanna and WCA had been consolidated in the comparable year ended June 30, 2016, UPMC would have recognized additional net patient service revenues of approximately $658,000 and an increase in excess of revenues over expenses of approximately $16,000.

Intangible assets are tested for recoverability whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. UPMC determined circumstances that included technology and financial performance relating to MedCPU, a consolidated but less than wholly-owned subsidiary, had changed in such a manner as to indicate impairment. For the year ended June 30, 2017, UPMC recorded a full non-cash impairment charge of $59,081 on intangible assets resulting from UPMC's acquisition of MedCPU, $40,879 of which is classified in the UPMC Enterprises activity line in the Consolidated Statements of Operations and Changes in Net Assets, and $18,202 that is attributable to noncontrolling interests.

3. CHARITY CARE

UPMC's patient acceptance policy is based on its mission and its community service responsibilities. Accordingly, UPMC accepts patients in immediate need of care, regardless of their ability to pay. UPMC does not pursue collection of amounts determined to qualify as charity care based on established policies of UPMC. These policies define charity care as those services for which no payment is due for all or a portion of the patient's bill. For financial reporting purposes, charity care is excluded from net patient service revenue. The amount of charity care provided, determined on the basis of cost, was $81,108 and $93,031 for the years ended June 30, 2017 and 2016, respectively. UPMC estimates the cost of providing charity care using the ratio of average patient care cost to gross charges and then applying that ratio to the gross uncompensated charges associated with providing charity care.

(IN THOUSANDS)

4. CASH AND INVESTMENTS

Following is a summary of cash and investments included in the consolidated balance sheets:

	June 30 2017	2016
Internally designated:		
Funded depreciation	**$ 5,940**	$ 8,150
Employee benefit and workers' compensation self-insurance programs	**96,552**	83,390
Professional and general liability insurance program	**526,204**	454,042
Health insurance programs	**898,911**	679,463
	1,527,607	1,225,045
Externally designated:		
Trusteed assets for capital and debt service payments	**40,248**	2,445
Donor-restricted assets	**223,725**	191,047
	263,973	193,492
Other long-term investments	**3,485,628**	3,246,395
Board-designated, restricted, trusteed, and other investments	**5,277,208**	4,664,932
Cash and cash equivalents	**673,447**	431,471
	$ 5,950,655	$ 5,096,403

Following is a summary of the composition of cash and investments. The table below shows all of UPMC's investments, including nonalternative investments measured at fair value and alternative investments using either the cost or equity method of accounting.

	June 30 2017	2016
Cash and cash equivalents	**$ 673,447**	$ 431,471
Nonalternative investments:		
Fixed income	**1,447,405**	1,129,068
Domestic equity	**617,183**	625,050
International equity	**513,824**	335,489
Public real estate	**71,809**	67,537
Long/short equity	**21,289**	34,635
Absolute return	**29,844**	91,081
Commodities	**3,723**	3,252
Other investments valued at NAV	**979,011**	802,552
	3,684,088	3,088,664
Alternative investments:		
Long/short equity	**177,903**	288,245
Absolute return	**304,513**	223,054
Private equity and other	**822,869**	772,613
Private real estate	**101,615**	121,504
Natural resources	**186,220**	170,852
	1,593,120	1,576,268
	$ 5,950,655	$ 5,096,403

(IN THOUSANDS)

Investments are primarily maintained in MTF and administered using a bank as trustee. As of June 30, 2017, UPMC utilized 245 ongoing external investment managers including 48 traditional managers, 17 hedge fund managers and 180 private capital managers. UPMC is also invested with an additional 9 legacy private capital managers. The largest allocation to any alternative investment fund is $52,458. Certain managers use various equity and interest rate derivatives. These instruments are subject to various risks similar to nonderivative financial instruments, including market, credit, liquidity, operational, and foreign exchange risk.

As of June 30, 2017 and 2016, respectively, UPMC had total investments recorded at cost of $896,055 and $836,247. These investments include private equity limited partnerships recorded at cost, as well as UPMC Enterprises direct investments recorded at cost. Distributions from each private equity fund will be received as the underlying assets of the fund are expected to be liquidated periodically over the lives of the limited partners, which generally run 10 to 12 years.

Investment return from cash and investments is comprised of the following for the years ended June 30, 2017 and 2016:

	Year Ended June 30	
	2017	2016
Interest income	**$ 57,169**	$ 44,291
Dividend income	**23,780**	24,717
Net realized gains on sales of securities	**296,412**	147,915
	377,361	216,923
Unrealized investment gains (losses)	**247,965**	(141,022)
Impairment losses on limited partnerships	**(24,399)**	(12,679)
Derivative contracts mark to market	**2,104**	4,558
	225,670	(149,143)
Total investment gain	**603,031**	67,780
Traditional investment manager and trustee fees	**(31,381)**	(35,370)
Investment revenue	**$ 571,650**	$ 32,410

In managing the UPMC investment strategy, an important consideration is to ensure sufficient liquidity. While UPMC's relationships with its external investment managers vary in terms of exit provisions, a percentage of the agreements allow ready access to underlying assets which are generally liquid and marketable. Investment liquidity as of June 30, 2017, is shown below:

Liquidity Availability	Cash and Cash Equivalents	Nonalternative Investments	Alternative Investments	Total
Within three days	$ 673,447	$ 3,431,078	$ -	$ 4,104,525
Within 30 days	-	90,208	46,283	136,491
Within 60 days	-	-	74,812	74,812
Within 90 days	-	-	178,258	178,258
More than 90 days	-	162,802	1,293,767	1,456,569
Total	$ 673,447	$ 3,684,088	$ 1,593,120	$ 5,950,655

(IN THOUSANDS)

5. CREDIT ARRANGEMENTS

UPMC has a revolving line and letter of credit facility (the "Revolving Facility") with an available line of $500,000. The Revolving Facility expires on July 31, 2019. The Revolving Facility is used to manage cash flow during the year and to provide for a consolidated method of issuing various letters of credit for certain business units. A note to secure UPMC's repayment obligation with respect to the Revolving Facility was issued under the 2007 Master Trust Indenture ("2007 UPMC MTI") and is secured by a pledge of and security interest in the gross revenues of UPMC Parent corporation, UPMC Presbyterian Shadyside, Magee-Women's Hospital of UPMC, UPMC Passavant and UPMC St Margaret as members of the obligated group under the 2007 UPMC MTI.

Advances may be variable rate based on the prime rate or the Federal Funds effective rates, or advances may be fixed on the date of the advance based on the LIBOR Rate and the reserve requirement on Eurocurrency liabilities. No amounts were outstanding under the Revolving Facility as of June 30, 2017. As of June 30, 2016, UPMC had $20,844 drawn under the Revolving Facility to refund the Hamot Series 2006 bonds. The $20,844 was paid off with the 2016 Series fixed rate bonds.

As of June 30, 2017, UPMC has issued $70,636 of letters of credit under the Revolving Facility. These letters of credit predominantly support the capital requirements of certain insurance subsidiaries. As of June 30, 2017, there was $429,364 available to borrow under the Revolving Facility.

As of June 30, 2017, recently affiliated entities have revolving credit facilities with borrowing limits of $7,500 and had $945 in letters of credit outstanding leaving $6,555 available to fund operating and capital needs, of which none was drawn.

In April 2017, two credit facilities totaling $200,000 were opened with expiration dates in April 2022. Both of these credit facilities support the Insurance Services division. As of June 30, 2017, draws on these credit facilities were $100,000, included in other current liabilities.

In September 2016, UPMC issued 2016 Series fixed rate bonds in the amount of $239,390 to fund new capital projects and refund existing bonds.

6. LONG-TERM OBLIGATIONS AND DERIVATIVE INSTRUMENTS

Long-term obligations consist of the following:

	June 30	
	2017	2016
Fixed rate revenue bonds	**$ 2,516,144**	$ 2,232,971
Variable rate revenue bonds	**694,316**	697,185
Capital leases and other	**78,157**	74,394
Par value of long-term obligations	**3,288,617**	3,004,550
Net premium and other	**77,118**	58,326
	3,365,735	3,062,876
Less current portion	**(367,235)**	(158,718)
Total long-term obligations	**$ 2,998,500**	$ 2,904,158

Revenue instruments outstanding represent funds borrowed by the UPMC parent corporation and various subsidiaries pursuant to loan agreements and lease and sublease financing arrangements with governmental authorities. The bond proceeds were used for the purchase, construction, and renovation of hospital facilities, certain buildings and equipment, as well as the extinguishment of debt.

(IN THOUSANDS)

The fixed rate revenue instruments bear interest at fixed coupon rates ranging from 1.90% to 6.00% in 2017 and from 1.30% to 6.00% in 2016. The average interest cost for the variable rate instruments was 1.45% and 0.87% during fiscal years 2017 and 2016, respectively. Revenue instruments have varying principal payments and final maturities from 2018 through 2045. Certain revenue bonds are secured by bond insurance ($73,116 and $76,094 in 2017 and 2016, respectively). The revenue bonds contain redemption provisions whereby, at the direction of UPMC, the bonds may be redeemed on various dates as presented within the bond agreements.

Revenue instruments in the aggregate amount of debt outstanding of $3,200,336 and $2,914,264 as of June 30, 2017 and 2016, respectively, are issued under the UPMC MTI. The instruments are secured by a pledge of and security interest in gross revenues. Certain amounts borrowed under the MTI are loaned to certain subsidiary corporations pursuant to loan and contribution agreements and require the transfer of subsidiary funds to the parent corporation in the event of failure to satisfy the UPMC Parent corporation liquidity covenant.

The various indebtedness agreements contain restrictive covenants, the most significant of which are the maintenance of minimum debt service coverage and liquidity ratios, and restrictions as to the incurrence of additional indebtedness and transfers of assets. UPMC was in compliance with such covenants as of June 30, 2017 and 2016.

Aggregate maturities of long-term obligations for the next five years, assuming remarketing of UPMC's variable rate debt, indicating the maximum potential payment obligations in these years, are as follows:

2018	$ 367,235
2019	162,048
2020	121,630
2021	117,651
2022	231,040

Interest paid, net of amounts capitalized, on all obligations was $129,247 and $122,367 during the years ended June 30, 2017 and 2016, respectively.

UPMC maintains interest rate swap programs on certain of its revenue bonds in order to manage its interest rate risk. To meet this objective and to take advantage of low interest rates, UPMC entered into various interest rate swap agreements to manage interest rate risk. The notional amount under each interest rate swap agreement is reduced over the term of the respective agreement to correspond with reductions in various outstanding bond series.

During the term of these agreements, the floating to fixed rate swaps convert variable rate debt to a fixed rate and the basis swaps convert the interest rate on underlying LIBOR-based bonds to the Securities Industry and Financial Markets Association Municipal Swap Index ("SIFMA Index").

Under the basis swaps, UPMC pays a rate equal to the SIFMA Index, an index of seven-day, high-grade, tax-exempt variable rate demand obligations. The SIFMA Index rates ranged from 0.39% to 0.92% (weighted average rate of 0.68%) in 2017 and from 0.01% to 0.43% (weighted average rate of 0.13%) in 2016.

(IN THOUSANDS)

The following table summarizes UPMC's interest rate swap agreements:

				Notional Amount at	
Swap	Maturity Date	UPMC Pays	UPMC Receives	**June 30, 2017**	June 30, 2016
Floating to fixed	2025	3.6%	68% one-month LIBOR	**$ 97,700**	$ 105,920
Floating to fixed	2018	1.2925%	70% one-month LIBOR	**17,222**	-
Basis	2021	SIFMA Index[1]	67% three-month LIBOR plus .2077%	**27,955**	34,340
Basis	2037	SIFMA Index[1]	67% three-month LIBOR plus .3217%	**46,095**	46,095
				$ 188,972	$ 186,355

[1] *The SIFMA Index is a 7-day high-grade market index comprised of tax-exempt variable rate demand obligations.*

After giving effect to the above derivative transactions, UPMC's variable rate debt was approximately 18% and 19% of the total debt outstanding as of June 30, 2017 and 2016, respectively.

The following table summarizes UPMC's equity swap agreements:

			Notional Amount at	
Maturity Date	UPMC Pays	UPMC Receives	**June 30, 2017**	June 30, 2016
2016	Three-month LIBOR plus .1500%	MSCI EAFE Daily Total Return[2]	**$ -**	$ 100,000
2017	One-month LIBOR plus .1750%	S&P 500 Total Return Index	**-**	100,000
2017	One-month LIBOR minus .0200%	MSCI All Country World Daily Total Return[1]	**-**	100,000
2017	Three-month LIBOR plus .1000%	MSCI EAFE Daily Total Return[2]	**100,000**	-
2018	One-month LIBOR plus .415%	S&P 500 Total Return Index	**100,000**	-
2018	One-month LIBOR plus .37%	S&P 500 Total Return Index	**100,000**	-
			$ 300,000	$ 300,000

[1] *The MSCI All Country World Daily Total Return is a free-float adjusted market capitalization index that is designed to measure the equity market performance of developed and emerging markets.*

[2] *The MSCI EAFE Index is a free-float adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US and Canada.*

Pursuant to master netting arrangements, UPMC has the right to offset the fair value of amounts recognized for derivatives, including the right to reclaim or obligation to return cash collateral from/to counterparties. The fair values of the Company's derivative financial instruments are presented below, representing the gross amounts recognized as of June 30, 2017 and June 30, 2016 which are not offset by counterparty or by type of item hedged:

	June 30, 2017	June 30, 2016
Other assets	**$ 343**	$ 5,647
Long-term obligations	**(10,709)**	(18,117)
	$ (10,366)	$ (12,470)

(IN THOUSANDS)

The effects of changes in the fair value of the derivative instruments on the consolidated statements of operations and changes in net assets for the years ended June 30, 2017 and 2016, are as follows:

Type of Derivative	Classification of Unrealized Gain (Loss) in Excess of Revenues Over Expenses		2017		2016
Interest rate contracts	Investment revenue	**$**	**5,231**	$	(1,679)
Equity index contracts	Investment revenue		**(3,127)**		6,237
		$	**2,104**	$	4,558

UPMC's derivatives contain provisions that require UPMC's debt to maintain an investment grade credit rating from certain major credit rating agencies. If UPMC's debt were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivatives could request payment or demand immediate and ongoing full overnight collateralization on derivatives in net liability positions. The aggregate fair value of all derivatives with credit-risk-related contingent features that are in a liability position at June 30, 2017 and 2016, is $10,115 and $16,022, respectively, for which UPMC has posted collateral of $0 in the normal course of business. If the credit-risk-related contingent features underlying these derivatives were triggered to the fullest extent on June 30, 2017, UPMC would be required to post an additional $10,338 of collateral to its counterparties.

7. FAIR VALUE MEASUREMENTS

As of June 30, 2017, UPMC held certain assets that are required to be measured at fair value on a recurring basis. These include certain board-designated, restricted, trusteed, and other investments and derivatives. UPMC's alternative investments are measured using either the cost or equity method of accounting and are therefore excluded from the fair value hierarchy tables presented herein.

The valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs are generally unsupported by market activity. The three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value, include:

- *Level 1* – Quoted prices for identical assets or liabilities in active markets.
- *Level 2* – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-driven valuations whose inputs are observable or whose significant value drivers are observable.
- *Level 3* – Instruments which have unobservable inputs that are supported by little to no market activity and are significant to the fair value of the assets or liabilities.

Other investments measured at fair value represent funds included on the balance sheet that are reported using the net asset value ("NAV") practical expedient as prescribed by ASU 2015-07, Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share. These amounts are not required to be categorized in the fair value hierarchy. The fair value of these investments is based on the net asset value information provided by the general partner.

The following tables represent UPMC's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2017 and 2016. The interest rate swaps are valued using internal models, which are primarily based on market observable inputs, including interest rate curves. When quoted market prices are unobservable for fixed income securities, quotes from independent pricing vendors based on recent trading activity and other relevant information, including market interest rate curves, referenced credit spreads and estimated prepayment rates where applicable, are used for valuation purposes. These investments are included in Level 2 and include corporate fixed income, government bonds, mortgage- and asset-backed securities and money market securities, which are included within fixed income and equities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

FAIR VALUE MEASUREMENTS AS OF JUNE 30, 2017

	Level 1	Level 2	Level 3	NAV	Total Carrying Amount
ASSETS					
Fixed income	**$ 488,327**	**$ 959,078**	**$ -**	**$ -**	**$ 1,447,405**
Domestic equity	**609,030**	**8,153**	**-**	**-**	**617,183**
International equity	**513,220**	**604**	**-**	**-**	**513,824**
Public real estate	**71,809**	**-**	**-**	**-**	**71,809**
Long/short equity	**16,827**	**4,462**	**-**	**-**	**21,289**
Absolute return	**29,844**	**-**	**-**	**-**	**29,844**
Commodities	**3,723**	**-**	**-**	**-**	**3,723**
Derivative instruments	**-**	**343**	**-**	**-**	**343**
Other investments	**-**	**-**	**-**	**979,011**	**979,011**
Total assets measured at fair value on a recurring basis	**$ 1,732,780**	**$ 972,640**	**$ -**	**$ 979,011**	**$ 3,684,431**
LIABILITIES					
Derivative instruments	**$ -**	**$ (10,709)**	**$ -**	**$ -**	**$ (10,709)**
Total liabilities measured at fair value on a recurring basis	**$ -**	**$ (10,709)**	**$ -**	**$ -**	**$ (10,709)**

FAIR VALUE MEASUREMENTS AS OF JUNE 30, 2016

	Level 1	Level 2	Level 3	NAV	Total Carrying Amount
ASSETS					
Fixed income	$ 343,096	$ 785,972	$ -	$ -	$ 1,129,068
Domestic equity	622,823	2,227	-	-	625,050
International equity	334,869	620	-	-	335,489
Public real estate	67,537	-	-	-	67,537
Long/short equity	20,661	13,974	-	-	34,635
Absolute return	30,942	60,139	-	-	91,081
Commodities	3,252	-	-	-	3,252
Derivative instruments	-	5,647	-	-	5,647
Other investments	-	-	-	802,552	802,552
Total assets measured at fair value on a recurring basis	$ 1,423,180	$ 868,579	$ -	$ 802,552	$ 3,094,311
LIABILITIES					
Derivative instruments	$ -	$ (18,117)	$ -	$ -	$ (18,117)
Total liabilities measured at fair value on a recurring basis	$ -	$ (18,117)	$ -	$ -	$ (18,117)

(IN THOUSANDS)

8. PENSION PLANS

UPMC and its subsidiaries maintain defined benefit pension plans (the "Plans"), defined contribution plans, and nonqualified pension plans that cover substantially all of UPMC's employees. Under the defined contribution plans, employees may elect to contribute a percentage of their salary, which is matched in accordance with the provisions of the plans. Contributions to the nonqualified pension plans are based on a percentage of salary or contractual arrangements. Total expense relating to the aforementioned pension plans was $181,166 and $156,853 for the years ended June 30, 2017 and 2016, respectively. Total expense related to the defined contribution plans and nonqualified plans was $91,977 and $84,323 for the years ended June 30, 2017 and 2016, respectively.

Benefits under the Plans vary and are generally based upon the employee's earnings and years of participation. It is UPMC's policy to meet the requirements of the Employee Retirement Income Security Act of 1974 ("ERISA") and the Pension Protection Act of 2006. UPMC's policy is to contribute amounts sufficient to, among other things, avoid Pension Benefit Guaranty Corporation variable premiums. Contributions made to the Plans were $262,438 and $89,835 for the years ended June 30, 2017 and 2016, respectively.

To develop the expected long-term rate of return on plan assets assumption, UPMC considers the current level of expected returns on risk-free investments, the historical level of risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns on each asset class. The expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

The table below sets forth the accumulated benefit obligation, the change in the projected benefit obligation, and the change in the assets of the Plans. The table also reflects the funded status of the Plans as well as recognized and unrecognized amounts in the consolidated balance sheets.

	June 30	
	2017	2016
Accumulated benefit obligation	**$ 2,119,569**	$ 1,991,897
CHANGE IN PROJECTED BENEFIT OBLIGATION		
Projected benefit obligation at beginning of year	**$ 2,070,717**	$ 1,904,305
Pension plans acquired	**92,080**	68,806
Service cost	**101,747**	95,075
Interest cost	**69,459**	80,060
Actuarial (gain) loss	**(26,864)**	60,825
Benefits paid	**(114,666)**	(138,354)
Projected benefit obligation at end of year	**2,192,473**	2,070,717
CHANGE IN PLAN ASSETS		
Fair value of plan assets at beginning of year	**1,673,026**	1,687,459
Pension plans acquired	**59,961**	46,803
Actual return on plan assets	**222,232**	(12,717)
Employer contributions	**262,438**	89,835
Benefits paid	**(114,666)**	(138,354)
Fair value of plan assets at end of year	**2,102,991**	1,673,026
Accrued pension liability	**$ 89,482**	$ 397,691

(IN THOUSANDS)

Included in unrestricted net assets at June 30, 2017 and 2016, respectively, are the following amounts that have not yet been recognized in net periodic pension cost:

	June 30	
	2017	2016
Unrecognized prior service credit	**$ 58,019**	$ 62,786
Unrecognized net actuarial loss	**(506,407)**	(678,253)
	$ (448,388)	$ (615,467)

Changes in plan assets and benefit obligations recognized in unrestricted net assets during 2017 and 2016 include:

	June 30	
	2017	2016
Current year net actuarial gain (loss)	**$ 117,731**	$ (209,331)
Amortization of actuarial loss	**53,321**	36,794
Amortization of net prior service credit	**(5,036)**	(5,027)
Amortization of plan merger	**1,063**	1,417
	$ 167,079	$ (176,147)

No plan assets are expected to be returned to UPMC during the year ending June 30, 2018.

The components of net periodic pension cost for the Plans were as follows:

	Year Ended June 30	
	2017	2016
Service cost	**$ 101,747**	$ 95,075
Interest cost	**69,459**	80,060
Expected return on plan assets	**(130,302)**	(134,372)
Recognized net actuarial loss	**53,321**	36,794
Amortization of prior service credit	**(5,036)**	(5,027)
Net periodic pension cost	**$ 89,189**	$ 72,530

The weighted average actuarial assumptions used to determine the benefit obligations and net periodic pension cost for the Plans are as follows:

	June 30	
	2017	2016
Discount rates:		
Used for benefit obligations	**3.78%**	3.60%
Used for net periodic pension cost	**3.60%**	4.36%
Expected rate of compensation increase:		
Used for benefit obligations	**Age-graded**	Age-graded
Used for net periodic pension cost	**Age-graded**	Age-graded
Expected long-term rate of return on plan assets	**7.50%**	7.50%
Interest crediting rate	**2.78%**	2.60%

The assumptions for long-term rate of return are developed using the expected returns of the various asset classes in which the pension invests and the allocations of each asset class with respect to the investment as a whole.

(IN THOUSANDS)

The change in discount rate from 3.60% to 3.78%, and the change in interest crediting rate from 2.60% to 2.78% had the effect of decreasing the projected benefit obligation by $17,269.

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the periods ending December 31:

2017	$ 94,563
2018	176,809
2019	171,341
2020	175,901
2021	178,811
2022-2026	902,331

UPMC employs a total return investment approach whereby a mix of equities and fixed income investments are used to maximize the long-term return on plan assets subject to accepting a prudent level of risk. Risk tolerance is established through consideration of plan liabilities, plan funded status, and corporate financial condition. The pension portfolio contains a diversified blend of equity, fixed-income, and alternative investments. Equity investments are diversified across United States and non-United States corporate stocks, as well as growth, value, and small and large capitalizations. Other assets such as real estate, private equity, and hedge funds are used to enhance long-term returns while improving portfolio diversification. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, annual liability measurements, and periodic asset/liability studies.

As of June 30, 2017, UPMC employed 148 external investment managers to handle the investment of the assets in the pension portfolio. Of these, 25 managers manage equity investments, 8 manage fixed income investments, and 115 managers oversee alternative investment strategies. The largest allocation to any alternative investment manager is $26,200. UPMC's unfunded commitments to the Plans' investments are $260,652 and $251,600 as of June 30, 2017 and 2016, respectively.

The following is a summary of the pension plan asset allocations at June 30, 2017 and 2016:

	2017	2016	2017 Target
Nonalternative investments:			
Fixed income	**15.1%**	13.5%	13.0%
Domestic equity	**23.8%**	16.5%	23.0%
International equity	**21.1%**	23.0%	22.0%
Total nonalternative investments	**60.0%**	53.0%	58.0%
Real assets:			
Real estate	**2.2%**	3.2%	4.0%
Income opportunities	**1.6%**	1.0%	2.0%
Natural resources	**3.4%**	3.1%	4.0%
Total real assets	**7.2%**	7.3%	10.0%
Alternative investments:			
Long/short equity	**9.7%**	12.0%	10.0%
Absolute return	**6.1%**	9.0%	7.0%
Private equity	**17.0%**	18.7%	15.0%
Total alternative investments	**32.8%**	39.7%	32.0%
Total	**100.0%**	100.0%	100.0%

(IN THOUSANDS)

All of the Plans' assets are measured at fair value, including its alternative investments. The same levels of the fair value hierarchy as described in Note 7 are used to categorize the Plans' assets. Corporate debt instruments and fixed income/bonds are valued using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. The fair value of common/collective trust funds is determined by the issuer sponsoring such funds by dividing the fund's net assets at fair value by its units outstanding at the valuation dates. Partnership interests are valued using net asset value ("NAV"), which is based on the unit values of the interests as determined by the issuer sponsoring such interests dividing the fund's net assets at fair value by its units outstanding at the valuation dates.

The fair values of the Plans' assets at June 30, 2017, by asset category and by the level of inputs used to determine fair value, were as follows:

	Level 1	Level 2	Level 3	NAV	Total
ASSETS					
Cash	$ 1,346	$ -	$ -	$ -	$ 1,346
Equity securities:					
Domestic equity	74,088	-	-	-	74,088
International equity	248,609	-	-	-	248,609
U.S. REITS	29,249	-	-	-	29,249
Fixed income:					
Government securities	17,524	-	-	-	17,524
Bond fund	13,758	-	-	-	13,758
Corporate debt instruments	-	22,163	-	-	22,163
Asset and mortgage-backed securities	-	78,131	-	-	78,131
Long/short equity	56,112	–	-	-	56,112
Other investments	–	–	-	1,568,685	1,568,685
Net payables	(6,674)	-	-	-	(6,674)
Plans' assets at fair value	$ 434,012	$ 100,294	$ -	$ 1,568,685	$ 2,102,991

(IN THOUSANDS)

The fair values of the Plans' assets at June 30, 2016, by asset category and by the level of inputs used to determine fair value, were as follows:

	Level 1	Level 2	Level 3	NAV	Total
ASSETS					
Cash	$ 1,480	$ –	$ –	$ –	$ 1,480
Equity securities:					
Domestic equity	104,031	–	–	–	104,031
International equity	142,279	–	–	–	142,279
U.S. REITS	27,357	–	–	–	27,357
Fixed income:					
Government securities	5,290	3,771	–	–	9,061
Bond fund	17,222	12,754	–	–	29,976
Corporate debt instruments	380	21,732	–	–	22,112
Asset and mortgage-backed securities	–	10,324	–	–	10,324
Absolute return equity	–	63,321	–	–	63,321
Long/short equity	27,870	–	–	–	27,870
Other investments	–	–	–	1,236,640	1,236,640
Net payables	(1,425)	–	–	–	(1,425)
Plans' assets at fair value	$ 324,484	$ 111,902	$ –	$ 1,236,640	$ 1,673,026

For the period ended June 30, 2018, UPMC anticipates contributing $107,000 to the defined benefit pension plan to maintain its funded status and to avoid paying excess premiums to the PBGC.

(IN THOUSANDS)

9. HEALTH INSURANCE REVENUE AND COSTS

UPMC's insurance subsidiaries (collectively, "Health Plans") provide health care services on a prepaid basis under various contracts. Insurance enrollment revenues are recognized as income in the period in which enrollees are entitled to receive health care services. Enrollment revenue from Medicare and Medical Assistance approximates 68% and 71% of total enrollment revenue for the years ended June 30, 2017 and 2016, respectively.

Health care costs were $6,200,427 and $5,564,153, of which $1,783,468 and $1,564,261 were eliminated in consolidation representing medical services performed by other UPMC entities for the years ended June 30, 2017 and 2016, respectively. Such costs are included in insurance claims expense. These costs include estimates of payments to be made on claims reported as of the balance sheet date and estimates of health care services rendered but not reported to the Health Plans. Such estimates include the cost of services that will continue to be rendered after the balance sheet date when the Health Plans are obligated to remit payment for such services in accordance with contract provisions or regulatory requirements.

	2017	2016
Reserve for physical health care costs (beginning balance)	**$ 326,549**	$ 310,548
Add: Provisions for medical costs occuring in:		
Current year	**5,423,218**	4,760,563
Prior year	**(43,536)**	(34,551)
Net incurred medical costs	**5,379,682**	4,726,012
Deduct: Payments for claims occurring in:		
Current year	**5,082,776**	4,434,015
Prior year	**283,013**	275,996
Net paid medical costs	**5,365,789**	4,710,011
Reserve for physical health care costs (ending balance)	**$ 340,442**	$ 326,549

The foregoing rollforward shows favorable development of $43,536 and $34,551 for the years ended June 30, 2017 and 2016. The reserve for health care costs and claims adjustment expenses was based on the best data available to UPMC; however, these estimates are subject to a degree of inherent variability. It is possible that UPMC's actual incurred costs and claim adjustment expenses will not conform to the assumptions inherent in the determination of the liability; accordingly, the ultimate settlement of health care costs and the related claims adjustment expenses may vary from the estimates included in the financial statements.

Unrestricted net assets required to meet statutory requirements of the Health Plans were $683,939 and $666,010 at June 30, 2017 and 2016, respectively.

10. PROFESSIONAL AND GENERAL LIABILITY INSURANCE

UPMC is insured for professional and general liability losses through wholly owned, multiprovider insurance companies ("Captives"). The Captives provide primary and excess professional liability coverage to UPMC subsidiaries, employed physicians of UPMC, and other entities not included in the consolidated financial statements. For those self-insured risks,UPMC has established irrevocable trust funds to pay claims and related costs.

(IN THOUSANDS)

Certain insurance agreements have retrospective clauses that permit additional premiums or refunds to be made based on actual experience. The reserve for professional and general liability indemnity losses and loss adjustment expenses is determined using individual case-based evaluations and statistical analyses and represents an estimate of reported claims and claims incurred but not reported. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserves for professional and general liability losses and loss adjustment expenses are reasonable. The estimates are reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in current operations. Reserves for professional and general liability losses and loss adjustment expenses of $353,285 and $346,382, both discounted at 1.50%, were recorded as of June 30, 2017 and 2016, respectively. At June 30, 2017 and 2016, respectively, $78,638 and $76,406 of the loss reserves are included in current accrued insurance reserves and $274,646 and $269,976 are reported as accrued long-term insurance reserves.

The following tables provide a rollforward of the reserve balances for professional and general liability costs (which are included in the current portion and long-term insurance reserve lines in the accompanying balance sheets), for the years ended June 30, 2017 and 2016.

	2017	2016
Reserve for professional and general liability costs (beginning balance)	**$ 346,382**	$ 335,642
Add: Provisions for expenses occuring in:		
Current year	**97,375**	89,786
Prior year	**(4,039)**	(12,036)
Net incurred expenses	**93,336**	77,750
Deduct: Payments for expenses occurring in:		
Current year	**(463)**	(462)
Prior year	**(85,970)**	(66,548)
Net paid expenses	**(86,433)**	(67,010)
Reserve for professional and general liability costs (ending balance)	**$ 353,285**	$ 346,382

The Medical Care Availability and Reduction of Error ("MCARE") Act was enacted by the legislature of the Commonwealth of Pennsylvania ("Commonwealth") in 2002. This Act created the MCARE Fund, which replaced The Pennsylvania Medical Professional Liability Catastrophe Loss Fund (the "Medical CAT Fund"), as the agency for the Commonwealth to facilitate the payment of medical malpractice claims exceeding the primary layer of professional liability insurance carried by UPMC and other health care providers practicing in the Commonwealth.

The MCARE Fund is funded on a "pay as you go basis" and assesses health care providers based on a percentage of the rates established by the Joint Underwriting Association (also a Commonwealth agency) for basic coverage. The MCARE Act of 2002 provides for a further reduction to the current MCARE coverage of $500 per occurrence to $250 per occurrence and the eventual phaseout of the MCARE Fund, subject to the approval of the PA Insurance Commissioner. To date, the PA Insurance Commissioner has deferred the change in coverage and eventual phaseout of the MCARE Fund to future years.

(IN THOUSANDS)

11. RELATED-PARTY TRANSACTIONS

UPMC monitors its relationships with related or affiliated entities on an ongoing basis. The most significant of these relationships is with the University of Pittsburgh ("the University") in which UPMC purchases and sells certain services from and to the University. The most significant payment to the University is for physician services in which the University, acting as a common paymaster, invoices UPMC for the clinical services rendered by certain faculty and medical residents. Payments to the University related to physician services amounted to $137,941 and $167,480 for the years ended June 30, 2017 and 2016, respectively. UPMC provides direct financial support to the University to sustain the research and academic medical enterprise of the University. Payments to the University related to research and academic support amounted to $159,538 and $118,813 for the years ended June 30, 2017 and 2016, respectively.

UPMC has various facility rental agreements with the University. UPMC received rent income of $21,916 and $23,350 and incurred rent expense of $10,089 and $10,793 related to rental arrangements with the University for the years ended June 30, 2017 and 2016, respectively. These rental agreements are also included in Note 12.

The University subcontracts with UPMC to perform research activity. Payments from the University related to research activity were $29,768 and $29,672 for the years ended June 30, 2017 and 2016, respectively.

12. OPERATING LEASES AND OTHER LONG-TERM AGREEMENTS

UPMC has entered into certain long-term agreements with respect to facilities, equipment, and services with affiliated and other entities. The terms of the agreements generally range from 1 to 25 years with renewal options up to 15 years. Total expense under these agreements was approximately $141,801 and $121,728 for the years ended June 30, 2017 and 2016, respectively, for all long-term agreements.

Approximately 0.66% of total future payments are subject to adjustment based upon inflation or mutual negotiations. Approximately 3.49% of these payments are due to the University.

2018	$ 96,450
2019	84,411
2020	68,169
2021	61,083
2022	56,056
Thereafter	304,448

13. INCOME TAXES

UPMC calculates income taxes using the balance sheet method for its taxable subsidiaries. Taxable income differs from pretax book income principally due to certain income and deductions for tax purposes being recorded in the financial statements in different periods. Deferred income tax assets and liabilities are recorded for the tax effect of these differences using enacted tax rates for the years in which the differences are expected to reverse. UPMC assesses the realization of deferred tax assets and the need for a valuation allowance to reduce those assets to their net realizable value based on future operations, reversal of existing temporary differences, carryforward and carryback periods for credits and net operating losses, and potential tax planning strategies that may exist.

(IN THOUSANDS)

As of June 30, 2017, the for-profit entities of UPMC had gross federal net operating loss ("NOL") carryforwards of $647,412 (expiring in years 2018 through 2037) and gross state NOL carryforwards of $414,067 (expiring in years 2019 through 2037) that are available to offset future taxable income. Utilization of the state NOL carryforwards in any one year is limited to the greater of $5,000 and 30% of taxable income on an annual basis per company. During the year ended June 30, 2017, UPMC realized tax benefits of $2,422 from the use of NOL carryforwards.

The following is a reconciliation of income taxes computed at the stutory U.S. Federal income tax rate to the actual effective income tax expense:

	2017	2016
Taxes computed at the federal rate	**$ (22,338)**	$ (26,824)
State income taxes, net of federal tax benefit	**913**	2,255
Valuation allowance	**10,147**	29,251
Permanent differences	**17,236**	21,253
Other items, net	**(1,007)**	(1,021)
Income tax expense	**$ 4,951**	$ 24,914

The following table presents deferred tax assets as of June 30:

	2017	2016
Deferred tax assets:		
Federal NOL	**$ 220,149**	$ 166,267
Accrued benefits	**16,792**	14,917
Alternative minimum tax credit carryover and other	**22,436**	15,623
	259,377	196,807
Less valuation allowance	**(253,830)**	(189,489)
	$ 5,547	$ 7,318

During the year ended June 30, 2017 UPMC closed an IRS examination for the tax years ended June 30, 2013 and 2014. As a result of this examination, UPMC's recorded NOL carry forward was increased by $153,235 as of June 30, 2017, which has been offset by a full valuation allowance.

Tax benefits are recognized when it is more likely than not that a tax position will be sustained upon examination by the tax authorities based on the technical merits of the position. Such tax positions are measured as the largest amount of tax benefit that is greater than 50% likely to be realized upon ultimate settlement with the tax authorities assuming full knowledge of the position and all relevant facts. As of June 30, 2017 and 2016, UPMC has a reserve for unrecorded tax benefits of $600. Certain of the Company's subsidiaries are subject to taxation in the United States, various states and foreign jurisdictions. As of June 30, 2017, the Company's returns for the fiscal years ended June 30, 2014, 2015, and 2016 are open for examination by the various taxing authorities.

(IN THOUSANDS)

14. FUNCTIONAL EXPENSES

UPMC provides general health care services primarily to residents within its geographic location and supports research and education programs. Reclassifications were made to the prior year presentation to conform to the current year presentation. For the years ended June 30, 2017 and 2016, expenses related to providing these services were as follows:

	2017	2016
Hospital health care services	**$ 5,827,164**	$ 5,002,309
Health insurance costs	**6,200,427**	5,564,153
Academic and research activities	**446,719**	407,172
UPMC Enterprises activity	**167,536**	79,388
Administrative support	**2,071,220**	1,932,006
	$ 14,713,066	$ 12,985,028

15. UPMC ENTERPRISES ACTIVITY

UPMC Enterprises conducts research, development and innovation activities on behalf of UPMC primarily focused on technologies for use in the healthcare industry to lower costs and improve care; such activities are expensed as incurred. From time to time, UPMC invests in companies that are developing technologies that align with its strategic imperatives, including companies that are not yet at the commercialization stage. UPMC's level of investment is dependent on numerous strategic considerations and may provide either a controlling or a non-controlling ownership interest. UPMC Enterprises also seeks partnerships with external companies to accelerate commercial growth of innovation activities, which may include the sale of internally developed technology solutions. Leveraging UPMC's long-standing reputation for academic and research excellence, UPMC Enterprises also sponsors the translation of basic science conducted in a research setting to its commercial use in bedside clinical practice, application in medical laboratories, or use across emerging venues where medicine is delivered; such activities are expensed as incurred.

UPMC Enterprises activity is comprised of the following for the years ended June 30:

	2017	2016
Technology research and development costs	**$ (49,636)**	$ (37,208)
Investments in translational science	**(5,979)**	–
Revenue from portfolio companies with controlling interest	**25,066**	8,252
Expenses of portfolio companies with controlling interest	**(63,097)**	(20,185)
Intangible asset charge	**(40,879)**	–
Net loss from non-controlling interest in portfolio companies	**(14,402)**	(29,138)
Net gains from sale of technology-related assets	**6,457**	7,143
UPMC Enterprises activity	**$ (142,470)**	$ (71,136)

16. CONTINGENCIES

In January 2012, UPMC Hamot was served with a Complaint in federal court naming it as a defendant in a qui tam action, along with a private physician practice. In July 2013, the Court denied UPMC Hamot's motion to dismiss an Amended Complaint. UPMC Hamot answered the Amended Complaint on September 18, 2013. On July 8, 2016, the parties filed competing motions for summary judgment. On March 15, 2017, the Court denied UPMC Hamot's motion for summary judgment and granted in part and denied in part the Relator's motion for summary judgment. On May 19, 2017, UPMC Hamot moved for reconsideration of the Court's order denying summary judgment on materiality. The Court has not yet ruled on this motion. Trial has been scheduled for November 7, 2017. The outcome and ultimate effect on UPMC's financial statements cannot be determined at this time.

On October 9, 2012, UPMC received a Civil Investigative Demand ("CID") from the Department of Justice ("DOJ") that sought records relating to 40 surgical procedures performed between January 25, 2008 and June 24, 2010. UPMC timely responded to that CID. In November 2013, the DOJ advised UPMC that the CID had been served as part of the DOJ's investigation of allegations asserted by Relators in a federal qui tam lawsuit filed under seal. On July 27, 2016, the DOJ announced that it had reached an agreement with UPMC to settle certain allegations that UPMC had violated the False Claims Act for approximately $2,500. UPMC admitted no liability in settling those claims. The DOJ declined to intervene in the remaining allegations of the Relators' lawsuit, which was also unsealed on July 27, 2016. In their Amended Complaint against UPMC and UPP, Inc., Relators allege that UPMC violated the False Claims Act violations, by overpaying physicians and encouraging physicians to perform medically unnecessary procedures. On June 21, 2017, the Court granted UPMC's motion to dismiss all claims, but provided leave to the Relators to file a Second Amended Complaint, which the Relators filed on July 20, 2017. UPMC's motion to dismiss the Second Amended Complaint is August 15, 2017. The outcome and ultimate effect on UPMC's financial statements cannot be determined at this time.

On September 3, 2014, Highmark Inc. and Keystone Health Plan West, Inc. sued UPMC and various UPMC hospitals and physician practices in the Court of Common Pleas of Allegheny County, Pennsylvania, asserting claims for breach of contract and declaratory judgment related to oncology billing. On March 24, 2015, the Court denied UPMC's preliminary objections to that Complaint. On April 2, 2015, UPMC filed a Notice of Appeal of the Court's March 24, 2015 Order. On December 2, 2016, the Pennsylvania Superior Court denied UPMC's appeal. On March 10, 2017, UPMC filed a Petition for Review with the Pennsylvania Supreme Court. That appeal was denied on July 25, 2017. The ultimate outcome and effect on UPMC's financial statements are unknown.

On July 24, 2017, PCS sued Allegheny County, UPMC, Workpartners, Inc UPMC Health Benefits, UPMC Benefit Management Services seeking to enjoin the awarding of a contract from the County to the UPMC Defendants UPMC's deadline to respond to the Complaint is August 15, 2017. The outcome and ultimate effect on UPMC's financial statements cannot be determined at this time.

On March 10, 2016, Karen DuVall sued UPMC Presbyterian Shadyside in the Court of Common Pleas of Allegheny County, Pennsylvania, alleging that UPMC negligently caused the death of the plaintiff's decedent, a transplant patient, by failing to prevent a fungal infection. On October 12, 2016, Jesse Krieg sued UPMC Montefiore in the Court of Common Pleas of Allegheny County, Pennsylvania, making similar allegations. After UPMC filed preliminary objections in both cases, DuVall and Krieg filed Second Amended Complaints on January 26, 2017, adding claims against Paris Cleaners, Inc., a linen supplier to UPMC. The plaintiffs alleged that Paris' linens caused the decedents' fungal infections. On February 14, 2017, Joanne Haines sued UPMC Presbyterian Shadyside and Paris Cleaners, Inc. in the Court of Common Pleas of Allegheny County, Pennsylvania, making allegations and claims similar to the Duvall and Krieg Second Amended Complaints. On April 20, 2017, Steven Landman sued UPMC Presbyterian Shadyside and Paris Cleaners, Inc. in the Court of Common Pleas of Allegheny County, Pennsylvania, making allegations and claims similar to the previous Complaints. UPMC is defending all four suits vigorously. The ultimate outcome and effect on UPMC's financial statements are unknown.

17. SUBSEQUENT EVENTS

Management evaluated events occurring subsequent to June 30, 2017 through August 29, 2017, the date the audited consolidated financial statements of UPMC were issued. During this period, there were no subsequent events requiring recognition in the consolidated financial statements that have not been recorded.

On July 28, 2017, UPMC and Pinnacle entered into an integration and affiliation agreement in which, among other things, UPMC would become the parent and sole member of Pinnacle, and Pinnacle would be renamed UPMC Pinnacle. Both parties expect an effective date on or around Sept. 1, 2017, subject to regulatory review and the satisfaction of customary closing conditions.