Advocate Aurora Health, Inc.

Condensed Consolidated Financial Statements and Other Information

As of and for the Six Months Ended June 30, 2019

Document Dated as of August 21, 2019

ADVOCATE AURORA HEALTH, INC.
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CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	Unaudited June 30, 2019	December 31, 2018
Assets		
Current assets		
Cash and cash equivalents	$ 345,514	$ 584,887
Assets limited as to use	111,045	106,244
Patient accounts receivable	1,670,516	1,486,260
Other current assets	609,017	512,556
Third-party payors receivables	15,873	17,793
Collateral proceeds under securities lending program	12,819	18,869
Total current assets	2,764,784	2,726,609
Assets limited as to use	8,546,708	7,712,087
Property and equipment, net	5,773,218	5,626,475
Other assets		
Intangible assets and goodwill, net	92,393	89,329
Investments in unconsolidated entities	216,629	202,331
Reinsurance receivable	61,031	60,741
Operating lease right of use assets	374,192	—
Other noncurrent assets	403,170	315,217
Total other assets	1,147,415	667,618
Total assets	$ 18,232,125	$ 16,732,789

(Continued)

ADVOCATE AURORA HEALTH, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	Unaudited June 30, 2019	December 31, 2018
Current liabilities		
Current portion of long-term debt and commercial paper	$ 104,152	$ 49,927
Long-term debt subject to short-term financing arrangements	147,535	162,025
Current portion of operating lease liabilities	76,795	—
Accounts payable and accrued liabilities	1,545,699	1,671,124
Third-party payors payables	343,448	303,633
Current portion of accrued insurance and claim costs	124,780	122,361
Collateral under securities lending program	12,819	18,869
Total current liabilities	2,355,228	2,327,939
Noncurrent liabilities		
Long-term debt, less current portion	2,783,274	2,796,906
Operating lease liabilities	335,921	—
Accrued insurance and claims cost, less current portion	597,568	593,296
Accrued losses subject to insurance recovery	61,031	60,741
Obligations under swap agreements	91,114	65,376
Other noncurrent liabilities	597,991	645,554
Total noncurrent liabilities	4,466,899	4,161,873
Total liabilities	6,822,127	6,489,812
Net assets		
Without donor restrictions		
Controlling interest	11,042,099	9,900,718
Noncontrolling interest in subsidiaries	130,303	118,468
Total net assets without donor restrictions	11,172,402	10,019,186
With donor restrictions	237,596	223,791
Total net assets	11,409,998	10,242,977
Total liabilities and net assets	$ 18,232,125	$ 16,732,789

(Concluded)

See accompanying notes to condensed consolidated financial statements.

ADVOCATE AURORA HEALTH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
(dollars in thousands)

	Unaudited		
	Three Months Ended June 30, 2019	**Three Months Ended June 30, 2018**	**Six Months Ended June 30, 2019**
Revenue			
Patient service revenue	$ 2,679,322	$ 2,462,661	$ 5,200,076
Capitation revenue	307,594	332,803	636,482
Other revenue	205,349	200,301	394,249
Total revenue	3,192,265	2,995,765	6,230,807
Expenses			
Salaries, wages and benefits	1,738,512	1,613,838	3,401,172
Supplies and purchased services	793,627	755,694	1,548,616
Contracted medical services	119,790	153,770	264,292
Other	190,353	187,572	371,135
Depreciation and amortization	139,301	136,241	276,351
Interest	27,245	26,864	54,584
Total expenses	3,008,828	2,873,979	5,916,150
Operating income before nonrecurring expenses	183,437	121,786	314,657
Nonrecurring expenses	51,102	14,545	69,543
Operating income	132,335	107,241	245,114
Nonoperating income			
Investment income, net	194,390	44,796	699,026
Change in fair value of interest rate swaps	(12,576)	5,060	(20,648)
Other nonoperating income, net	104,224	1,607	104,227
Total nonoperating income, net	286,038	51,463	782,605
Revenue in excess of expenses	418,373	158,704	1,027,719
Less noncontrolling interest	(14,183)	(12,451)	(26,751)
Revenue in excess of expenses - attributable to controlling interest	$ 404,190	$ 146,253	$ 1,000,968

(Continued)

ADVOCATE AURORA HEALTH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
(dollars in thousands)

	Unaudited		
	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Net assets without donor restrictions, controlling interest			
Revenue in excess of expenses - attributable to controlling interest	$ 404,190	$ 146,253	$ 1,000,968
Pension-related changes other than net periodic pension costs	112,522	2,742	114,181
Net assets released from restrictions for purchase of property and equipment	958	2,713	1,745
Other, net	61	1,840	1,060
Increase in net assets without donor restrictions, controlling interest	517,731	153,548	1,117,954
Net assets without donor restrictions, noncontrolling interest			
Revenues in excess of expenses	14,183	12,451	26,751
Distributions to noncontrolling interest	(7,358)	(6,611)	(14,916)
Other, net	—	(81)	—
Increase in net assets without donor restrictions, noncontrolling interest	6,825	5,759	11,835
Net assets with donor restrictions			
Contributions	10,166	4,630	13,499
Investment income, net	2,965	268	8,954
Net assets released from restrictions for operations	(4,373)	(4,902)	(7,749)
Net assets released from restrictions for purchase of property and equipment	(958)	(2,713)	(1,745)
Other, net	879	(1,132)	846
Increase in net assets with donor restrictions	8,679	(3,849)	13,805
Increase in net assets	533,235	155,458	1,143,594
Net assets at beginning of period	10,876,763	10,280,393	10,242,977
Adoption of ASU 2016-02 (Leases)	—	—	23,427
Net assets at end of period	$ 11,409,998	$ 10,435,851	$ 11,409,998

(Concluded)

See accompanying notes to condensed consolidated financial statements.

ADVOCATE AURORA HEALTH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

	Unaudited		
	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Cash flows from operating activities			
Increase in net assets	$ 533,235	$ 155,458	$ 1,143,594
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation, amortization and accretion	138,595	134,441	274,336
Loss (gain) on sale of property and equipment	1,074	(1,122)	1,212
Change in fair value of swap agreements	12,576	(5,060)	20,648
Pension-related changes other than net periodic pension cost	(112,522)	(2,742)	(114,181)
Restricted contributions and gains on investments, net	(5,731)	(3,308)	(7,749)
of assets released from restrictions used for operations			
Non-cash lease expense	16,930	—	34,229
Distribution to noncontrolling interest	13,970	24,348	20,125
Gain on Bay Area Medical Center acquisition	(88,600)	—	(88,600)
Changes in operating assets and liabilities			
Trading securities, net	(344,134)	(95,307)	(849,326)
Accounts receivable, net	(51,404)	(68,322)	(168,533)
Accounts payable and accrued liabilities	(16,705)	(59,587)	(96,850)
Third-party payors receivable and payable, net	13,879	71,467	41,246
Other assets and liabilities, net	(103,514)	3,568	(121,089)
Net cash provided by operating activities	7,649	153,834	89,062
Cash flows from investing activities			
Capital expenditures	(130,684)	(146,545)	(289,982)
Proceeds from sale of property and equipment	78	1,868	565
Purchases of investments designated as non-trading, net	14,928	15,774	(1,423)
Investments in unconsolidated entities, net	(32,539)	(864)	(29,859)
Investments acquired in Bay Area Medical Center acquisition	34,018	—	34,018
Other	(1,880)	9,041	(20,883)
Net cash used in investing activities	(116,079)	(120,726)	(307,564)
Cash flows from financing activities			
Proceeds from issuance of debt	6,104	—	56,104
Repayments of long-term debt and other obligations	(25,588)	(24,589)	(79,303)
Distribution to noncontrolling interest	(13,970)	(24,348)	(20,125)
Proceeds from restricted contributions and gains on investments	16,256	3,675	22,453
Net cash used in financing activities	(17,198)	(45,262)	(20,871)
Net decrease in cash and cash equivalents	(125,628)	(12,154)	(239,373)
Cash and cash equivalents at beginning of period	471,142	408,105	584,887
Cash and cash equivalents at end of period	$ 345,514	$ 395,951	$ 345,514
Supplemental disclosures of non-cash information			
Operating lease right of use assets in exchange for new operating lease liabilities	$ 24,009	$ —	$ 412,106

See accompanying notes to condensed consolidated financial statements.

1. ORGANIZATION AND BASIS OF PRESENTATION

Description of Business

Advocate Aurora Health, Inc., is a Delaware nonprofit corporation ("the Parent Corporation"). On April 1, 2018, the Parent Corporation became the sole corporate member of Advocate Health Care Network, an Illinois not-for-profit corporation ("Advocate") and Aurora Health Care, Inc., a Wisconsin nonstock not-for-profit corporation ("Aurora"). The Parent Corporation, Advocate and Aurora and their controlled subsidiaries are collectively referred to herein as the "System." The System was formed in furtherance of the parties' common and unifying charitable health care mission to promote and improve the quality and expand the scope and accessibility of affordable health care and health care-related services for the communities they serve.

The System is comprised of various not-for-profit and for-profit entities, the primary activities are the delivery of health care services or the provision of goods and services ancillary thereto.

The System provides a continuum of care through its 28 acute care hospitals, including an integrated children's hospital and a psychiatric hospital, primary and specialty physician services, outpatient centers, physician office buildings, pharmacies, rehabilitation and home health and hospice care in northern and central Illinois and eastern Wisconsin.

On April 1, 2019, the System became the sole corporate member of Bay Area Medical Center ("BAMC") through the acquisition of the remaining 51% interest in BAMC. The acquisition will improve the availability, scope and access to health care in the communities served by BAMC. As of April 1, 2019, BAMC is fully consolidated within the condensed consolidated financial statements of the System.

Basis of Presentation

The accompanying condensed consolidated financial statements for the three and six months ended June 30, 2019, have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim reporting. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in these financial statements. Included in the System's condensed consolidated financial statements are all its controlled subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The condensed consolidated financial statements do not include all the information and footnotes required by GAAP for complete financial statements. As such the condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of and for the nine months ended December 31, 2018. The audited consolidated financial statements are available from the Municipal Securities Rulemaking Board ("MSRB") on its Electronic Municipal Market Access ("EMMA") system, found at http://emma.msrb.org. Additional information can be found on the investor relations section of the System's website at https://www.advocateaurorahealth.org/investor-relations.

Operating results for the three and six months ended June 30, 2019 are not necessarily indicative of the results that may be experienced during the year ending December 31, 2019.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities and amounts disclosed in the notes to the condensed consolidated financial statements at the date of the condensed consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time made, actual results could differ materially from those estimates.

Cash Equivalents

The System considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Investments

The System has designated substantially all of its investments as trading. Investments in debt and equity securities with readily determinable fair values are measured at fair value using quoted market prices or otherwise observable inputs. Investments in private equity limited partnerships and derivative products (hedge funds) are reported at fair value using net asset value as a practical expedient. Commingled funds are carried at fair value based on other observable inputs. Investment income or loss (including realized gains and losses, interest, dividends and unrealized gains and losses) is included in the nonoperating section of the condensed consolidated statements of operations and changes in net assets unless the income or loss is restricted by donor or law or is related to assets designated for self-insurance programs. Investment income on self-insurance trust funds is reported in other revenue in the condensed consolidated statements of operations and changes in net assets. Investment income that is restricted by donor or law is reported as a change in net assets with donor restrictions.

Assets Limited as to Use

Assets limited as to use consist of investments set aside by the System for future capital improvements and certain medical education and other health care programs. The System retains control of these investments and may, at its discretion, subsequently use them for other purposes. Additionally, assets limited as to use include investments held by trustees or in trust under debt agreements, self-insurance trusts, assets held in reinsurance trust accounts and donor-restricted funds.

Patient Service Revenue and Accounts Receivable

Patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care payors and government programs and excludes revenues for services provided to patient's under capitated arrangements) and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, patients and third-party payors are billed within days after the services are performed or after discharge. Revenue is recognized as performance obligations are satisfied. Provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in future periods as additional information becomes available and final settlements are determined.

As the System's performance obligations relate to contracts with a duration of less than one year, the System has applied the optional exemption provided in the guidance and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The System does not adjust the promised amount of consideration from patients and third-party payers for the effects of a significant financing component due to the expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payer pays for that service will be one year or less.

The System has entered into payment arrangements with patients that allow for payments over a term in excess of one year. The System has evaluated historical collections in excess of one year and current market interest rates to determine whether a significant financing component exists that would require an adjustment to the promised amount of consideration from patients and third-party payors. The System has determined that the impact of implicit financing arrangements for payment agreements in excess of one year is insignificant to the condensed consolidated statements of operations and changes in net assets.

The System does not incur significant incremental costs in obtaining contracts with patients. Any costs that are incurred are expensed in the period of occurrence, as the amortization period of any asset that the System would have recognized is one year or less in duration.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a possibility that recorded estimates will change by a material amount.

Inventories

Inventories, consisting primarily of medical supplies, pharmaceuticals and durable medical equipment, are stated at the lower of cost (first-in, first-out) or market. Retail pharmaceutical inventories are stated at replacement cost.

Reinsurance Receivables

Reinsurance receivables are recognized in a manner consistent with the liabilities relating to the underlying reinsured contracts.

Intangible Assets and Goodwill, Net

Goodwill of $68,888 and $65,862 is included in intangible assets and goodwill, net in the accompanying condensed consolidated balance sheets at June 30, 2019 and December 31, 2018, respectively. Goodwill is not amortized and is evaluated for impairment at least annually. Intangible assets with expected useful lives are amortized over that period.

Asset Impairment

The System considers whether indicators of impairment are present and performs the necessary tests to determine if the carrying value of an asset is appropriate. Impairment write-downs are recognized in the condensed consolidated statements of operations and changes in net assets as a component of operating expense at the time the impairment is identified.

Property and Equipment, Net

Property and equipment are reported at cost or, if donated, at fair value at the date of the gift. Costs of computer software developed or obtained for internal use, including external and internal direct costs of materials and labor directly associated with internal-use software development projects, are capitalized and included in property and equipment. Internal labor and interest expense incurred during the period of construction of significant capital projects is capitalized as a component of the costs of the asset.

Property and equipment capitalized under direct financing leases are recorded at the present value of future lease payments, adding initial direct costs and prepaid lease payments, reduced by any lease incentives. Property and equipment capitalized under direct financing leases are amortized using the straight-line method over the related lease term. Amortization of property and equipment under financing leases is included in the accompanying condensed consolidated statements of operations and changes in net assets in depreciation and amortization expense.

Property and equipment assets are depreciated on the straight-line method over a period ranging from 3 years to 80 years.

Operating Lease Right of Use Assets

The System records an operating lease right of use asset (that is an asset that represents the System's right to use the leased asset for the lease term) for leases that do not meet the criteria as a sales-type lease or a direct financing lease.

The System records operating lease right of use assets at the present value of future lease payments, adding initial direct costs and prepaid lease payments, reduced by any lease incentives. Operating right of use assets are amortized using the straight-line method over the related lease term. Amortization of operating lease right of use assets is included in the accompanying condensed consolidated statements of operations and changes in net assets in other expense.

Included within operating lease right of use assets are assets that the System previously sold and then leased back. Those sale/leaseback transactions, which related to various administrative and medical support buildings, did not meet the accounting criteria as a sales-type lease or a direct financing lease. The buyer-lessors for such transactions are generally unrelated special-purpose entities.

Investments in Unconsolidated Entities

Investments in unconsolidated entities are accounted for using the cost or equity method. The System applies the equity method of accounting for investments in unconsolidated entities when its ownership or membership interest is 50% or less and the System exercises significant influence over the operating and financial policies of the investee. All other unconsolidated entities are accounted for using the cost method. The income (loss) on health care-related unconsolidated entities is included in other revenue in the accompanying condensed consolidated statements of operations and changes in net assets. The income (loss) on non health care-related unconsolidated entities is included within other nonoperating income, net.

Derivative Financial Instruments

The System has entered into transactions to manage its interest rate, credit and market risks. Derivative instruments, including exchange-traded and over-the-counter derivative contracts and interest rate swaps, are recorded as either assets or liabilities at fair value. Subsequent changes in a derivatives fair value are recognized in nonoperating income.

Bond Issuance Costs, Discounts and Premiums

Bond issuance costs, discounts and premiums are amortized over the term of the bonds using the effective interest method and are included in long-term debt in the condensed consolidated balance sheets.

General and Professional Liability Risks

The provision for self-insured general and professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The System measures the cost of its unfunded obligations under such programs based upon actuarial calculations and records a liability on a discounted basis.

Net Assets with Donor Restrictions

Net assets with donor restrictions are those assets whose use by the System has been limited by donors to a specific time period or purpose or consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity. Net assets with donor restrictions are used in accordance with the donor's wishes primarily to purchase property and equipment, to fund medical education or to fund health programs.

Assets released from restrictions to fund purchases of property and equipment are reported in the condensed consolidated statements of operations and changes in net assets as increases to net assets without donor restrictions. Those assets released from restriction for operating purposes are reported in the condensed consolidated statements of operations and changes in net assets as other revenue. When restricted, earnings are recorded as net assets with donor restrictions until amounts are expended in accordance with the donor's specifications.

Other Nonoperating Income, Net

Revenues and expenses from delivering health care services and the provision of goods and services ancillary thereto are reported in operations. Income and losses that arise from transactions that are peripheral or incidental to the System's main purpose are included in other nonoperating income, net. Other nonoperating income, net primarily consists of a gain on the acquisition of BAMC, fund-raising expenses, contributions to charitable organizations, income taxes and the net non-service components of the periodic benefit expense on the System's pension plans.

Nonrecurring Expenses

The System has incurred salaries, purchased services and other expenses in connection with the formation of the System, the implementation of an electronic medical records and billing system, the implementation of an enterprise resource planning system and, as part of the initiative to reduce operating expenses, an early retirement incentive program. As a result, these costs were recorded as nonrecurring in the condensed consolidated statements of operations and changes in net assets.

Revenue in Excess of Expenses and Changes in Net Assets

The condensed consolidated statements of operations and changes in net assets includes the revenue in excess of expenses as the performance indicator. Changes in net assets without donor restrictions, which are excluded from revenue in excess of expenses, primarily include contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets), pension-related changes other than net periodic pension costs and distributions to noncontrolling interests.

Accounting Pronouncements Adopted

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This guidance introduced a lessee model that brings most leases on to the balance sheet. The standard also aligns certain of the underlying principles of the new lessor model with those in ASU 2014-09, the revenue recognition standard. This standard was adopted by the System effective January 1, 2019, using the modified retrospective approach. The System elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed the System to carry forward the historical lease classification.

The System recorded a right of use asset of $388,097 and right of use liabilities of $426,794 due to the adoption of this standard. Additionally, the System recognized a cumulative-effect adjustment of $23,427 to net assets without donor restrictions on January 1, 2019 related to the deferred gains on various sale-leaseback transactions.

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Contract*. This guidance requires an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset and which costs to expense as incurred. Also, this guidance requires the entity to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. Further, the guidance requires the entity to present the expense related to the capitalized implementation costs in the same line item in the consolidated statement of operations and changes in net assets as the fees associated with the hosting element (service) of the arrangement and classify payments for capitalized implementation costs in the consolidated statement of cash flows in the same manner as payments made for fees associated with the hosting element. The entity is also required to present the capitalized implementation costs in the condensed consolidated balance sheets in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented. This guidance is effective for the fiscal years and interim periods within those fiscal years beginning after December 15, 2020, early adoption is permitted. The System early adopted this guidance effective January 1, 2019, on a prospective basis.

In June 2018, the FASB issued ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This guidance clarifies whether a transfer of assets is a contribution or an exchange transaction and further clarifies how an entity determines whether a resource provider is participating in an exchange transaction by evaluating whether the resource provider is receiving commensurate value in return for the resources transferred. This standard was effective for the System beginning January 1, 2019, on a modified prospective basis. This guidance did not have a material impact on the System's condensed consolidated statements of operations and changes in net assets.

In November 2016, the FASB issued ASU 2016-18, *Restricted Cash*. This guidance will require restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the consolidated statement of cash flows. This guidance is effective for the fiscal years beginning after December 15, 2018 and interim periods after December 15, 2019. The System adopted this standard effective January 1, 2019. Management is currently assessing the impact this ASU will have on its consolidated financial statements at December 31, 2019.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*, which amends guidance in Accounting Standards Codification (ASC) 230 on the classification of certain cash receipts and payments in the statement of cash flows. This standard is effective for the System beginning January 1, 2019 for annual reporting. This guidance did not have a material impact on the

System's condensed consolidated statements of cash flows, with the primary change being the movement of certain distributions from equity method investees from cash used in investing activities to cash flows from operations.

Accounting Pronouncements Not Yet Adopted

In May 2019, the FASB issued ASU 2019-06, *Intangibles- Goodwill and Other (Topic 350), Business Combinations (Topic 805) and Not-for-Profit Entities (Topic 958)*. This guidance allows not-for-profits to apply accounting alternatives in Topic 350 and Topic 805. A not-for-profit entity can amortize goodwill on a straight-line basis over 10 years, or less than 10 years if the not-for-profit entity demonstrates that a shorter useful life is more appropriate. A not-for-profit entity that elects this accounting alternative is required to make an accounting policy election to test goodwill for impairment at either the entity level or the reporting unit level. This guidance is effective immediately and should be applied prospectively for goodwill recognized after the alternative is adopted. The guidance will be applied to existing goodwill as of the beginning of the annual period of adoption. The System is evaluating the effect this guidance will have on its consolidated financial statements.

Reclassifications in the Condensed Consolidated Financial Statements

Certain reclassifications were made to the 2018 condensed consolidated financial statements to conform to the classifications used in 2019. There was no impact on previously reported 2018 net assets or revenues in excess of expenses.

3. REVENUE AND RECEIVABLES

Patient Service Revenue

Patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care payors and government programs and excludes revenues for services provided to patient's under capitated arrangements) and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, patients and third-party payors are billed shortly after discharge. Revenue is recognized as performance obligations are satisfied. Patient service revenue does not include revenue for services provided to patient's covered under capitated arrangements.

Performance obligations are identified based on the nature of the services provided. Revenue associated with performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. Performance obligations satisfied over time relate to patients receiving inpatient acute care services. The System measures the performance obligation from admission into the hospital to the point when there are no further services required for the patient, which is generally the time of discharge. For outpatient services, the performance obligation is satisfied as the patient simultaneously receives and consumes the benefits provided as the services are performed. In the case of these outpatient services, recognition of the obligation over time yields the same result as recognizing the obligation at a point in time. Management believes this method provides a faithful depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations.

The System uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and major payor classes and types of services provided for outpatient revenue. Based on the historical collection trends and other analysis, the System believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

The System determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, reduced by explicit and implicit price concessions, including contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with policy and/or implicit price concessions based on the historical collection experience of patient accounts. The System determines the transaction price associated with services provided to patients who have third-party payor coverage based on reimbursement terms per contractual agreements, discount policies and historical experience. For uninsured (and underinsured in the case of Advocate) patients who do not qualify for charity care, the System determines the transaction price associated with services based on of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on historical collection experience for applicable patient portfolios. Patients who meet the System's criteria for free care “charity” are provided care without charge; such amounts are not reported as revenue. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care using the most likely outcome method. These settlements are estimated based on the terms of the payment agreements with the payor, correspondence from the payor and historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as new information becomes available or as years are settled or are no longer subject to such audits, reviews and investigations.

For the three months ended June 30, 2019 and 2018, and the six months ended June 30, 2019 changes in the System’s estimates of implicit price concessions, discounts and contractual adjustments or other reductions to expected payments for performance obligations in prior years were not significant.

In certain instances, the System does receive payment in advance of the services provided and would consider these amounts to represent contract liabilities. Contract liabilities at June 30, 2019 and 2018 were not significant.

Currently, the state of Illinois utilizes supplemental reimbursement programs to supplement reimbursement to providers to offset a portion of the cost of providing care to Medicaid and indigent patients. These programs are designed with input from the Centers for Medicare and Medicaid Services and are funded with a combination of state and federal resources including assessments levied on the providers. Under these supplemental programs, the System recognizes revenue and related expenses in the period in which amounts are estimable and collection is reasonably assured. Reimbursement and the assessment under these programs is reflected in the condensed consolidated statements of operations and changes in net assets are as follows:

	Classification	**Three Months Ended June 30, 2019**	**Three Months Ended June 30, 2018**	**Six Months Ended June 30, 2019**
Reimbursement	Patient service revenue	$ 67,815	$ 65,289	$ 135,630
Assessment	Other expense	41,306	42,273	82,611

The state of Wisconsin assesses a fee or tax on gross patient service revenue. The revenues from this assessment are used to increase payments made to hospitals for services provided to Medicaid and other medically indigent patients. The System's patient service revenue reflects this increase in payment for services to Medicaid and other medically indigent patients and hospital tax assessment expense reflects the fees assessed by the state. Reimbursement and the assessment under these programs is reflected in the condensed consolidated statements of operations and changes in net assets are as follows:

	Classification	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Reimbursement	Patient service revenue	$ 25,057	$ 25,010	$ 56,854
Assessment	Other expense	25,296	24,558	49,940

The System has filed formal appeals relating to the settlement of certain prior-year Medicare cost reports. The outcome of these appeals cannot be determined at this time.

Management has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payors geographical location, the line of business that renders services to patients and the timing of when revenue is recognized and billed.

The composition of patient service revenue by payor is as follows:

Three Months Ended June 30,	**2019**		**2018**	
Managed care	$ 1,504,132	56%	$ 1,378,176	56%
Medicare	820,355	31	741,340	30
Medicaid - Wisconsin	101,156	4	99,498	4
Medicaid - Illinois	190,611	7	176,912	7
Self-pay and other	63,068	2	66,735	3
	$ 2,679,322	100%	$ 2,462,661	100%

Six Months Ended June 30, 2019		
Managed care	$ 2,903,935	56%
Medicare	1,574,591	31
Medicaid - Wisconsin	220,648	4
Medicaid - Illinois	378,711	7
Self-pay and other	122,191	2
	$ 5,200,076	100%

Deductibles, copayments and coinsurance under third-party payment programs, which are the patient's responsibility, are included within the primary payor category in the tables above.

Capitation Revenue

The System has agreements with various managed care organization under which the System provides or arranges for medical care to members of the organizations in return for a monthly payment per member. Revenue is earned each month as a result of the System agreeing to provide or arrange for their medical care.

Other Revenue

Other revenue is recognized at an amount that reflects the consideration to which the System expects to be entitled in exchange for providing goods and services. The amounts recognized reflect consideration due from customers, third-party payors and others. Primary categories of other revenue include income from joint ventures, retail pharmacy revenue, grant revenue, cafeteria revenue, rent revenue and other miscellaneous revenue.

Revenue disaggregation by state and business line are as follows:

Three Months Ended June 30,	**2019**	**2018**
Wisconsin	$ 1,467,053	$ 1,313,029
Illinois	1,519,863	1,482,435
Total patient service revenue and capitation	2,986,916	2,795,464
Other revenue	205,349	200,301
Total revenue	$ 3,192,265	$ 2,995,765
Hospital	$ 1,970,761	$ 1,846,159
Clinic	618,389	541,573
Home Care	62,639	51,162
Other	27,533	23,767
Total patient service revenue	2,679,322	2,462,661
Capitated revenue	307,594	332,803
Other revenue	205,349	200,301
Total revenue	$ 3,192,265	$ 2,995,765

Six Months Ended June 30, 2019	
Wisconsin	$ 2,829,157
Illinois	3,007,401
Total patient service revenue and capitation	5,836,558
Other revenue	394,249
Total revenue	$ 6,230,807
Hospital	$ 3,850,071
Clinic	1,178,429
Home Care	120,087
Other	51,489
Total patient service revenue	5,200,076
Capitated revenue	636,482
Other revenue	394,249
Total revenue	$ 6,230,807

Patient Accounts Receivable

The System's patient accounts receivable is reported at the amount that reflects the consideration to which it expects to be entitled, in exchange for providing patient care. The revenues related to patient accounts receivable are reported at net realizable value based on certain assumptions. For third-party payors including Medicare, Medicaid and Managed Care, the net realizable value is based on the estimated contractual reimbursement percentage, which is based on current contract prices or historical paid claims data by payor. For self-pay, the net realizable value is determined using estimates of historical collection experience including an analysis by aging category. These estimates are adjusted for expected recoveries and any anticipated changes in trends including significant changes in payor mix and economic conditions or trends in federal and state governmental health care coverage.

The composition of patient accounts receivable is summarized as follows:

	June 30, 2019			December 31, 2018		
Managed care	$	724,647	43%	$	627,409	42%
Medicare		349,551	21		285,837	19
Medicaid - Wisconsin		50,387	3		39,958	3
Medicaid - Illinois		205,073	12		229,139	15
Self-pay and other		340,858	21		303,917	21
	$	1,670,516	100%	$	1,486,260	100%

The self-pay patient accounts receivable above includes amounts due from patients for co-insurance, deductibles, installment payment plans and amounts due from patients without insurance.

4. INVESTMENTS

The System invests in a diversified portfolio of investments, including alternative investments, such as real asset funds, hedge funds and private equity limited partnerships. Collectively, these funds have liquidity terms ranging from daily to annual with notice periods typically ranging from 1 to 90 days. Due to redemption restrictions, investments in certain of these funds, whose fair value was approximately $3,960,218 and $3,685,071 at June 30, 2019 and December 31, 2018, respectively, cannot currently be redeemed for periods ranging from one to eleven years. However, the potential for the System to sell its interest in these funds in a secondary market prior to the end of the fund term does exist, for prices at or other than the then carrying value.

At June 30, 2019, the System had additional commitments to fund alternative investments, including recallable distributions of $1,086,632 over the next seven years.

In the normal course of operations and within established investment policy guidelines, the System may enter into various exchange-traded and over-the-counter derivative contracts for trading purposes, including futures, options and forward contracts. These instruments are used primarily to maintain the System's strategic asset allocation. These instruments require the System to deposit cash collateral with the broker or custodian. Collateral provided was $29,269 and $44,560 at June 30, 2019 and December 31, 2018, respectively. The notional value of the derivatives in long positions was $152,121 and $190,305 at June 30, 2019 and December 31, 2018, respectively. The notional value of the derivatives in a short position was $0 and $(129,391) at June 30, 2019 and December 31, 2018, respectively.

By using derivative financial instruments, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty, and therefore, it does not possess credit risk. The System minimizes the credit risk in derivative instruments by entering into transactions that may require the counterparty to post collateral for the benefit of the System based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a change in the underlying reference security. The market risk associated with market changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Receivables and payables for investment trades not settled are presented with other current assets and accounts payable and accrued liabilities. Unsettled sales resulted in receivables due from brokers of $112,452 and $37,699 at June 30, 2019 and December 31, 2018, respectively. Unsettled purchases resulted in payables of $74,279 and $13,494 at June 30, 2019 and December 31, 2018, respectively.

Investment returns for assets limited as to use and cash and cash equivalents are comprised of the following:

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Interest income and dividends	$ 23,119	$ 25,879	$ 47,430
Income from alternative investments	135,807	58,654	278,512
Net realized gains	34,720	22,781	101,754
Net unrealized gains (losses)	14,447	(50,773)	299,962
Total	$ 208,093	$ 56,541	$ 727,658

Investment returns are included in the condensed consolidated statements of operations and changes in net assets as follows:

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Other revenue	$ 10,738	$ 11,477	$ 19,678
Investment income, net	194,390	44,796	699,026
Net assets with donor restrictions	2,965	268	8,954
Total	$ 208,093	$ 56,541	$ 727,658

The non-current portion of assets limited as to use presented within the condensed consolidated balance sheets is comprised of the following as of June 30, 2019 and December 31, 2018 as follows:

	June 30, 2019	December 31, 2018
Internally designated for capital and other	$ 7,740,567	$ 6,941,646
Held for self-insurance	665,071	632,372
Donor restricted	128,897	119,759
Investments under securities lending program	12,173	18,310
Total	$ 8,546,708	$ 7,712,087

5. FAIR VALUE

The System accounts for certain assets and liabilities at fair value and categorizes assets and liabilities measured at fair value in the condensed consolidated financial statements based upon whether the inputs used to determine their fair values are observable or unobservable. Observable inputs are inputs which are based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about pricing the asset or liability, based on the best information available under the circumstances.

The fair value of all assets and liabilities recognized or disclosed at fair value is classified based on the lowest level of significant inputs. Assets and liabilities that are measured at fair value are disclosed and classified in one of three categories. Category inputs are defined as follows:

Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities on the reporting date.

Level 2 — Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 — Inputs that are unobservable for the asset or liability for which there is little or no market data.

The following section describes the valuation methodologies used by the System to measure financial assets and liabilities at fair value. In general, where applicable, the System uses quoted prices in active markets for identical assets and liabilities to determine fair value. This pricing methodology applies to Level 1 investments such as domestic and international equities, exchange-traded funds and agency securities.

If quoted prices in active markets for identical assets and liabilities are not available to determine fair value, then quoted prices for similar assets and liabilities or inputs other than quoted prices that are observable either directly or indirectly are used. These investments are included in Level 2 and consist primarily of corporate notes and bonds, foreign government bonds, mortgage-backed securities, fixed-income securities, including fixed-income government obligations, commercial paper and certain agency, United States and international equities, which are not traded on an active exchange. The fair value for the obligations under swap agreements included in Level 2 is estimated using industry standard valuation models. These models project future cash flows and discount the future amounts to a present value using market-based observable inputs, including interest rate curves. The fair values of the obligation under swap agreements include adjustments related to the System's credit risk.

Investments owned by the System are exposed to various kinds and levels of risk. Equity securities and equity funds expose the entity to market risk, performance risk and liquidity risk for both domestic and international investments. Market risk is the risk associated with major movements of the equity markets. Performance risk is that risk associated with a company's operating performance. Fixed-income securities and fixed-income mutual funds expose the System to interest rate risk, credit risk and liquidity risk. As interest rates change, the value of many fixed income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell particular securities. Liquidity risk tends to be higher for equities related to small capitalization companies and certain alternative investments. Due to the volatility in the capital markets, there is a reasonable possibility of subsequent changes in fair value resulting in additional gains and losses in the near term.

The carrying values of cash and cash equivalents, accounts receivable and payable, other current assets and accrued liabilities are reasonable estimates of their fair values due to the short-term nature of these financial instruments.

The fair values of financial assets and liabilities that are measured at fair value on a recurring basis are as follows:

	June 30, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investments				
Cash and short-term investments	$ 810,039	$ 763,504	$ 46,535	$ —
Corporate bonds and other debt securities	568,729	—	568,729	—
United States government bonds	560,776	—	560,776	—
Bond and other debt security funds	623,618	109,609	514,009	—
Non-government fixed-income obligations	26,977	—	26,977	—
Equity securities	742,679	742,679	—	—
Equity funds	1,688,881	127,807	1,561,074	—
	5,021,699	$ 1,743,599	$ 3,278,100	$ —
Investments at net asset value				
Alternative investments	3,981,568			
Total investments	$ 9,003,267			
Collateral proceeds received under securities lending program	$ 12,819		$ 12,819	
Liabilities				
Obligations under swap agreements	$ (91,114)		$ (91,114)	
Obligations to return capital under securities lending program	$ (12,819)		$ (12,819)	

	December 31, 2018		Quoted Prices in Active Markets for Identical Assets (Level 1)		Other Significant Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)
Assets							
Investments							
Cash and short-term investments	$	807,549	$ 430,889	$	376,660	$	—
Corporate bonds and other debt securities		577,406	—		577,406		—
United States government bonds		609,160	—		609,160		—
Bond and other debt security funds		578,088	102,552		475,536		—
Non-government fixed-income obligations		26,328	—		26,328		—
Equity securities		1,164,533	1,164,533		—		—
Equity funds		933,104	185,247		747,857		—
		4,696,168	$ 1,883,221	$	2,812,947		—
Investments at net asset value							
Alternative investments		3,707,050					
Total investments	$	8,403,218					
Collateral proceeds received under securities lending program	$	18,869		$	18,869		
Liabilities							
Obligations under swap agreements	$	(65,376)		$	(65,376)		
Obligations to return capital under securities lending program	$	(18,869)		$	(18,869)		

6. PROPERTY AND EQUIPMENT, NET

The components of property and equipment are summarized as follows:

	June 30, 2019	December 31, 2018
Land and improvements	$ 495,652	$ 473,862
Buildings and fixed equipment	7,341,412	7,102,622
Movable equipment and computer software	2,831,424	2,956,722
Construction-in-progress	346,770	306,531
Total property and equipment	11,015,258	10,839,737
Accumulated depreciation and amortization	(5,242,040)	(5,213,262)
Property and equipment, net	$ 5,773,218	$ 5,626,475

Property and equipment include assets recorded as finance leases and under other financing arrangements. See additional disclosure in Note 7. LEASES.

Depreciation expense is as follows:

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Depreciation expense	$ 139,660	$ 135,286	$ 276,882

7. LEASES

The System leases office and clinical space, land and equipment. Leases with an initial term of 12 months or less are not recorded on the balance sheet. For lease agreements entered into after the adoption of ASU 2016-02 on January 1, 2019, the System combines lease and non-lease components except for medical equipment leases.

The depreciable lives of assets are limited by the expected lease terms. Most leases include options to renew. The majority of leases do not provide an implicit rate, therefore the System has elected to use its incremental borrowing rate, which is the interest rate the System would borrow on a collateralized basis over a similar term, as the discount rate. The System used its incremental borrowing rate on January 1, 2019 for operating leases that commenced prior to that date.

Operating and finance leases are classified as follows within the condensed consolidated balance sheets at June 30, 2019:

Leases	Classification	
Assets		
Operating	Operating lease right of use assets	$ 374,192
Finance	Property and equipment, net	130,476
Total lease assets		$ 504,668
Liabilities		
Current		
Operating	Current portion of operating lease liabilities	$ 76,795
Finance	Current portion of long-term debt and commercial paper	8,694
Noncurrent		
Operating	Operating lease liabilities	335,921
Finance	Long-term debt, less current portion	144,121
Total lease liabilities		$ 565,531

Finance lease assets are recorded net of accumulated amortization of $45,720 as of June 30, 2019.

Lease costs are classified as follows within the condensed consolidated statements of operations and changes in net assets:

Lease cost	Classification	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Operating lease cost	Other	$ 21,246	$ 42,041
Short term lease cost	Other	3,410	5,974
Variable lease cost	Other	7,585	11,774
Finance lease cost			
Amortization of lease assets	Depreciation and amortization	2,433	4,878
Interest on lease liabilities	Interest	1,963	4,026
Sublease income	Other revenue	(680)	(1,378)
Net lease cost		$ 35,957	$ 67,315

Lease terms, discount rates and other supplemental information as of June 30, 2019 and for the three and six months ended June 30, 2019 are as follows:

Weighted average remaining lease term (in years):	
Operating	6.1
Finance	12.2
Weighted average discount rate	
Operating	2.34%
Finance	5.84%

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	$ 22,124	$ 43,561
Operating cash flows from finance leases	2,076	4,224
Financing cash flows from finance leases	1,789	3,503

Future maturities of lease liabilities at June 30, 2019 are as follows:

	Operating Leases	Finance Leases	Total
2019	$ 43,096	$ 10,684	$ 53,780
2020	85,210	16,085	101,295
2021	76,788	16,160	92,948
2022	66,632	16,506	83,138
2023	56,672	16,287	72,959
Thereafter	116,161	141,262	257,423
Future minimum lease payments	444,559	216,984	661,543
Less remaining imputed interest	31,843	64,169	96,012
Total	$ 412,716	$ 152,815	$ 565,531

Future maturities of lease liabilities at December 31, 2018, prior to the adoption of ASU 2016-02, were as follows:

	Long-Term Non-Cancelable Operating Leases	Capital Leases	Total
2019	$ 91,870	$ 7,366	$ 99,236
2020	86,204	8,153	94,357
2021	78,659	8,329	86,988
2022	67,928	9,177	77,105
2023	58,784	9,615	68,399
Thereafter	139,111	128,779	267,890
Total	$ 522,556	$ 171,419	$ 693,975

8. INVESTMENTS IN UNCONSOLIDATED ENTITIES

As of April 1, 2019, the System acquired the remaining 51% interest in Bay Area Medical Center ("BAMC") as part of an acquisition. See additional discussion of this transaction in Note 16. ACQUISITION OF BAY AREA MEDICAL CENTER. BAMC is a 99-bed general acute care hospital located in Marinette, Wisconsin. Prior to the acquisition, the System had a 49% interest in BAMC that was accounted for under the equity method of accounting and was presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. The System's investment in BAMC at December 31, 2018 was $26,547.

At the time of the acquisition, BAMC and the System owned a 73% and 27% interest, respectively, in Aurora Bay Area Medical Group ("ABAMG"). ABAMG provides inpatient, outpatient and other professional medical services in Marinette, Wisconsin and its surrounding communities. As part of the acquisition of BAMC, the System now owns 100% of ABAMG and its financial results are included in the consolidated financial results of the System. The System's investment in ABAMG was accounted for under the equity method and was presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. The System's investment in ABAMG at December 31, 2018 was $703.

In conjunction with the BAMC transaction, the System contributed $25,000 to the M&M Foundation, a newly formed foundation. This interest in the M&M Foundation is reflected in investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. Under the terms of the definitive agreement between the System and BAMC, the use of the $25,000 contribution is designated to support the operations and capital needs of BAMC and/or ABAMG.

The System has an interest in the net assets of the Masonic Family Health Foundation ("MFHF"), an independent organization, under the terms of an asset purchase agreement (the "Agreement"). The use of substantially all of MFHF's net assets are designated to support the operations and/or capital needs of one of the System's medical facilities. Additionally, 90% of MFHF's investment yield, net of expenses, on substantially all of MFHF's investments is designated for the support of one of the System's medical facilities. MFHF must pay the System, annually, 90% of the investment yield or an agreed-upon percentage of the beginning of the year net assets.

The interest in the net assets of MFHF amounted to $92,821 and $81,865 at June 30, 2019 and December 31, 2018, respectively, and is presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. The System's interest in the investment income is reflected in the condensed consolidated statements of operations and changes in net assets and amounted to $4,040 and $1,700 for the three months ended June 30, 2019, and 2018, respectively and $12,756 for the six months ended June 30, 2019. Cash distributions of $0 and $3,347 and were received by the System from MFHF under terms of the Agreement during the three and six months ended June 30, 2019, respectively. In addition, MFHF made no contributions to the System for program support during the three and six months ended June 30, 2019.

At June 30, 2019, the System had a 49.5% ownership interest in RML Health Providers, L.P. ("RML") that is accounted for on an equity basis. RML is an Illinois, not-for-profit limited partnership that operates a 115-bed licensed long-term acute care hospital in Hinsdale, Illinois, and a 86-bed licensed long-term acute care hospital in Chicago, Illinois. The System's carrying value of this interest was $37,569 and $33,883 at June 30, 2019 and December 31, 2018, respectively, and is presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets.

RML leases the Chicago, Illinois, facility from the System. The lease has a fixed term through June 30, 2020, with a five-year renewal term remaining executable at the option of RML. The System recorded rental income of $570 for the six months ended June 30, 2019.

The summarized financial position and results of operations for significant entities accounted for under the equity method as of and for the periods ended outlined below:

	RML	MFHF
As of June 30, 2019		
Total assets	$ 131,580	$ 94,362
Total liabilities	67,936	2,307
Equity	63,644	92,055
Three Months Ended June 30, 2019		
Total revenue	28,659	4,080
Net income (loss)	4,419	2,982
Three Months Ended June 30, 2018		
Total revenue	27,873	679
Net income (loss)	3,687	171
Six Months Ended June 30, 2019		
Total revenue	55,798	12,753
Net income (loss)	8,247	10,593
As of December 31, 2018		
Total assets	125,087	85,533
Total liabilities	56,994	3,440
Equity	68,093	82,093

9. LONG-TERM DEBT

The System's outstanding bonds are secured by obligations issued under the Second Amended and Restated Master Trust Indenture dated as of August 1, 2018, as the same may be amended from time to time, between Advocate Aurora Health, Inc., the other affiliates identified therein as the Members of the Obligated Group and U.S. Bank National Association, as master trustee ("the System Master Indenture"). Under the terms of the bond indentures and other arrangements, various amounts are to be on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The System Master Indenture and other debt agreements, including bank agreements, also place restrictions on the System and require the System to maintain certain financial ratios.

The System's unsecured variable rate revenue bonds, Series 2008A-1 of $42,045, Series 2008A-2 of $35,490 and Series 2011B of $70,000, while subject to a long-term amortization period, may be put to the System at the option of the bondholders in connection with certain remarketing dates. To the extent that bondholders may, under the terms of the debt, put their bonds within 12 months after June 30, 2019, the principal amount of such bonds has been classified as a current obligation in the accompanying condensed consolidated balance sheets. Management believes the likelihood of a material amount of bonds being put to the System is remote. However, to address this possibility, the System has taken steps to provide various sources of liquidity, including assessing alternate sources of financing, including lines of credit and/or net assets without donor restrictions as a source of self-liquidity.

The System has standby bond purchase agreements with banks to provide liquidity support for the Series 2008C Bonds. In the event of a failed remarketing of a supported Series 2008C Bond upon its tender by an existing holder and subject to compliance with the terms of the standby bond purchase agreement, the standby bank would provide the funds for the purchase of such tendered bonds, and the System would be obligated to repay the bank for the funds it provided for such bond purchase (if such bond is not subsequently remarketed), with the first installment of such repayment commencing on the date one year and one day after the bank purchases the bond. As of June 30, 2019, there were no bank-purchased bonds outstanding. To the extent that the standby bond purchase agreement expiration date is within 12 months after June 30, 2019, the principal amount of such bonds would be classified as a current obligation in the accompanying condensed consolidated balance sheets. The standby bond purchase agreements expire as follows: $145,919 in August 2021 and $129,456 in January 2024.

In August 2018, the Wisconsin Health and Educational Facilities Authority ("WHEFA"), for the benefit of the System, issued its Revenue Bonds, Series 2018ABC, in the amount of $487,895 and the System issued its Series 2018 Taxable Bonds, in the amount of $714,500. The proceeds of the Series 2018ABC Bonds and the Series 2018 Taxable Bonds were used to refund certain WHEFA Bonds previously issued for the benefit of Aurora, refinance Aurora's taxable bonds, the drawn portion of an Aurora line of credit and to pay certain financing costs. In connection with this transaction, the System recognized a loss on refinancing in the amount of $29,859.

On March 5, 2019, the System issued commercial paper in the amount of $50,000. The proceeds of the commercial paper were used to redeem the Series 2008C-2A bonds of $49,230 plus accrued interest, and certain costs related to the issuance of the commercial paper. The remaining proceeds were used for general corporate purposes. The standby bond purchase agreement related to the Series 2008C-2A bonds was canceled effective March 5, 2019.

In connection with the BAMC acquisition, the System assumed $81,465 of outstanding tax-exempt bonds. WHEFA had originally issued Bay Area Series 2015A of $40,000 with a fixed rate and Bay Area Series 2015B of $45,600 with a variable interest rate for the benefit of BAMC. These bonds were purchased by a bank in a private placement transaction. Also in connection with the BAMC acquisition, the System acquired an interest rate swap. As the debt related to the swap is no longer outstanding it is being held as a swap portfolio. These bonds and the swap are secured under the System Master Indenture.

The System maintains an interest rate swap program on certain of its variable rate debt as described in Note 10. INTEREST RATE SWAP PROGRAM.

The System's interest paid, net of capitalized interest and capitalized interest are as follows:

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Interest paid, net of capitalized interest	$ 22,785	$ 31,600	$ 59,208
Capitalized interest	1,161	300	1,264

At June 30, 2019, the System had lines of credit with banks aggregating to $225,000. These lines of credit provide for various interest rates and payment terms and as of June 30, 2019 expire as follows: $100,000 in December 2019, $25,000 in August 2020 and $100,000 in August 2021. These lines of credit may be used to redeem bonded indebtedness, to pay costs related to such redemptions, for capital expenditures or for general working capital purposes. As of June 30, 2019, under a line of credit there are various letters of credit issued totaling $46,773. At June 30, 2019, no amounts were outstanding on these lines or letters of credit.

10. INTEREST RATE SWAP PROGRAM

The System has interest rate-related derivative instruments to manage exposure of its variable rate debt instruments. By using derivative financial instruments to manage the risk of changes in interest rates, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty, and therefore, it does not possess credit risk. The System minimizes the credit risk in derivative instruments by entering into transactions that may require the counterparty to post collateral for the benefit of the System based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse 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. The System also mitigates risk through periodic reviews of its derivative positions in the context of its total blended cost of capital.

At June 30, 2019, the System maintains an interest rate swap program on its Series 2008C variable rate demand revenue bonds. These bonds expose the System to variability in interest payments due to changes in interest rates. The System believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, the System entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps convert the variable rate cash flow exposure on the variable rate demand revenue bonds to synthetically fixed cash flows. The notional amount under each interest rate swap agreement is reduced over the term of the respective agreement to correspond with reductions in the principal outstanding under various bond series. As the Series 2008C-2A bonds were canceled effective March 5, 2019, the portion of the swap related to these bonds are now held as a swap portfolio.

In connection with the BAMC acquisition, the System acquired an interest rate swap. As the debt related to the swap is no longer outstanding it is being held as a swap portfolio.

The following is a summary of the outstanding positions under these interest rate swap agreements at June 30, 2019:

Bond Series	Notional Amount		Maturity Date	Rate Received	Rate Paid
2008C-1	$	129,900	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
2008C-2B		58,425	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
2008C-3A		88,000	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
Swap portfolio		50,000	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
Swap portfolio		27,770	February 1, 2038	70.0% of LIBOR	3.314%

The swaps are not designated as hedging instruments, and therefore, hedge accounting has not been applied. As such, unrealized changes in fair value of the swaps are classified as changes in fair value of interest rate swaps in the condensed consolidated statements of operations and changes in net assets. The net cash settlement payments, representing the realized changes in fair value of the swaps, are included as interest expense in the condensed consolidated statements of operations and changes in net assets.

The fair value of the interest rate swap agreements was a liability of $91,114 and $65,376 as of June 30, 2019 and December 31, 2018, respectively. No collateral was posted under these swap agreements as of June 30, 2019 and December 31, 2018.

Amounts recorded in the condensed consolidated statements of operations and changes in net assets are as follows:

	Three Months Ended June 30, 2019		Three Months Ended June 30, 2018		Six Months Ended June 30, 2019	
Net cash payments on interest rate swap agreements (interest expense)	$	1,591	$	1,745	$	3,079
Change in fair value of interest rate swaps	$	(12,576)	$	5,060	$	(20,648)

The interest rate swap instruments contain provisions that require the System to maintain an investment grade credit rating on its tax-exempt bonds from certain major credit rating agencies. If the System's tax-exempt bonds were to fall below investment grade, it would be in violation of these provisions and the counterparties to the swap instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on interest rate swap instruments in net liability positions.

11. RETIREMENT PLANS

The System maintains various employee retirement benefit plans available to qualifying employees and retirees.

Advocate maintains a defined benefit pension plans that cover substantially all of its' employees. The condensed consolidated balance sheets contain an other noncurrent asset related to the Advocate Health Care Network Pension Plan ("Advocate Plan") totaling $40,487 and a noncurrent liability $45,570 at June 30, 2019 and December 31, 2018, respectively. In June 2019, the System approved a plan to freeze the Advocate Plan effective December 31, 2019. As of December 31, 2019 the Advocate Plan will be closed to new participants and participants will cease to accrue additional pension benefits. The Advocate Plan was remeasured as of June 30, 2019 and a curtailment loss of $72 was recorded in nonoperating income, net in the condensed consolidated statements of operations and changes in net assets. In addition, $86,396 of previously unrecognized net actuarial loss was recognized in net assets without donor restrictions as a component of pension-related changes other than net periodic pension cost. During the three and six months ended June 30, 2019, no contributions were made to the Advocate Plan.

In addition, the condensed consolidated balance sheets contain an other noncurrent asset related to the Condell Health Network Retirement Plan ("Condell Plan") of $1,413 and $1,424 at June 30, 2019 and December 31, 2018, respectively. The Condell Plan was frozen effective January 1, 2008, to new participants and participants ceased to accrue additional pension benefits. During the three and six months ended June 30, 2019, no contributions were made to the Condell Plan.

The condensed consolidated balance sheets contain an other noncurrent liability related to the Aurora defined benefit pension plan ("Aurora Plan") of $99,539 and $104,979 at June 30, 2019 and December 31, 2018, respectively. The Aurora Plan was frozen on December 31, 2012. During the three and six months ended June 30, 2019, no contributions were made to the Aurora plan.

Pension plan expense (income) included in the condensed consolidated statements of operations and changes in net assets is as follows:

Three Months Ended June 30, 2019

	Advocate	Condell	Aurora	Total
Service cost	$ 14,303	$ —	$ —	$ 14,303
Interest cost	10,693	582	15,662	26,937
Expected return on plan assets	(16,176)	(604)	(19,046)	(35,826)
Amortization of:				
Actuarial loss	1,817	27	1,908	3,752
Prior service cost	(36)	—	1	(35)
Settlement/curtailment	(72)	—	—	(72)
Net pension expense (income)	$ 10,529	$ 5	$ (1,475)	$ 9,059

Three Months Ended June 30, 2018

	Advocate	Condell	Aurora	Total
Service cost	$ 13,760	$ —	$ —	$ 13,760
Interest cost	8,777	625	15,125	24,527
Expected return on plan assets	(16,626)	(708)	(19,142)	(36,476)
Amortization of:				
Actuarial loss	1,324	420	—	1,744
Prior service cost	(996)	—	2,940	1,944
Net pension expense (income)	$ 6,239	$ 337	$ (1,077)	$ 5,499

Six Months Ended June 30, 2019

	Advocate	Condell	Aurora	Total
Service cost	$ 28,606	$ —	$ —	$ 28,606
Interest cost	21,386	1,164	31,324	53,874
Expected return on plan assets	(32,352)	(1,208)	(38,092)	(71,652)
Amortization of:				
Actuarial loss	3,634	54	3,816	7,504
Prior service cost	(72)	—	3	(69)
Settlement/curtailment	(72)	—	—	(72)
Net pension expense (income)	$ 21,130	$ 10	$ (2,949)	$ 18,191

The components of net periodic benefit costs other than the service cost component are included in other nonoperating income, net in the condensed consolidated statements of operations and changes in net assets.

Expected employee benefit payments are as follows:

	Advocate	Condell	Aurora	Total
2019	$ 79,786	$ 6,739	$ 62,238	$ 148,763
2020	66,794	4,310	66,384	137,488
2021	71,046	4,087	70,097	145,230
2022	75,632	3,865	73,191	152,688
2023	75,410	4,982	76,022	156,414
2024-2028	409,915	18,761	413,823	842,499
Total	$ 778,583	$ 42,744	$ 761,755	$ 1,583,082

The System's asset allocation and investment strategies are designed to earn returns on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, economic sectors and manager style to minimize the risk of loss. The System utilizes investment managers specializing in each asset category and, where appropriate, provides the investment manager with specific guidelines that include allowable and/or prohibited investment types. The System regularly monitors manager performance and compliance with investment guidelines.

The System's target and actual pension asset allocations for the plans are as follows:

	June 30, 2019		December 31, 2018	
Asset Category - Advocate Plan	**Target**	**Actual**	**Target**	**Actual**
Domestic and international equity securities	83%	21%	35%	34%
Alternative investments	7	45	45	46
Cash and fixed-income securities	10	34	20	20
	100%	100%	100%	100%

	June 30, 2019		December 31, 2018	
Asset Category - Condell Plan	**Target**	**Actual**	**Target**	**Actual**
Domestic and international equity securities	15%	15%	15%	15%
Cash and fixed-income securities	85	85	85	85
	100%	100%	100%	100%

	June 30, 2019		December 31, 2018	
Asset Category - Aurora Plan	**Target**	**Actual**	**Target**	**Actual**
Domestic and international equity securities	33%	34%	33%	33%
Real estate	3	3	3	3
Cash and fixed-income securities	64	63	64	64
	100%	100%	100%	100%

Assumptions used to determine benefit obligations are as follows:

	June 30, 2019
Discount rate - Advocate Plan	3.58%
Discount rate - Condell Plan	4.38%
Discount rate - Aurora Plan	4.48%
Assumed rate of return on assets - Advocate Plan	5.00%
Assumed rate of return on assets - Condell Plan	4.25%
Assumed rate of return on assets - Aurora Plan	5.50%

The assumed rate of return on each Plan's assets is based on historical and projected rates of return for asset classes in which the portfolio is invested. As the Advocate Plan will be frozen on December 31, 2019, the assumed rate of return and the target asset allocations were adjusted on June 30, 2019 and actual allocations are being adjusted to more closely align with the new target allocations.

In addition to these plans, the System sponsors various defined contribution plans for its employees. Contributions to these plans, which are included in salaries, wages and benefits expense in the condensed consolidated statements of operations and changes in net assets are as follows:

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019
Contributions	$ 55,031	$ 48,400	$ 110,055

12. FUNCTIONAL EXPENSES

For the three months ended June 30, 2019 and 2018, and the six months ended June 30, 2019 the majority of the System's expenses were directly attributable to the provision of health care services. The remaining expenses, primarily legal, finance, purchasing and human resources were attributable to general and administrative functions. Fundraising expense are primarily reported within other nonoperating income, net in the condensed consolidated statements of operations and changes in net assets.

13. LIQUIDITY

The System's financial assets available within one year of the consolidated balance sheets date for general expenditures are as follows:

	June 30, 2019	December 31, 2018
Current assets		
Cash and cash equivalents	$ 345,514	$ 584,887
Assets limited as to use	111,045	106,244
Patient accounts receivable	1,670,516	1,486,260
Third-party payors receivables	15,873	17,793
Collateral proceeds under securities lending program	12,819	18,869
Total current assets	2,155,767	2,214,053
Assets limited as to use		
Internally designated for capital and other	7,740,567	6,941,646
Held for self-insurance	665,071	632,372
Donor restricted	128,897	119,759
Investments under securities lending program	12,173	18,310
Total assets limited as to use	8,546,708	7,712,087
Total financial assets	10,702,475	9,926,140
Less		
Amounts unavailable for general expenditures		
Private equity	(1,224,389)	(1,113,544)
Hedge funds	(368,223)	(343,603)
Total amounts unavailable for general expenditure	(1,592,612)	(1,457,147)
Amounts unavailable to management without approval		
Held for self-insurance	(776,116)	(738,616)
Donor restricted	(128,897)	(119,759)
Investments under securities lending program	(12,173)	(18,310)
Total amounts unavailable to management without approval	(917,186)	(876,685)
Total financial assets available to management for general expenditure within one year	$ 8,192,677	$ 7,592,308

14. GENERAL AND PROFESSIONAL LIABILITY RISKS

The System is self-insured for substantially all general and professional liability risks. The self-insurance programs combine various levels of self-insured retention with excess commercial insurance coverage. Aurora's hospitals, clinics, surgery centers, physicians and certified registered nurse anesthetist providers that provide health care in Wisconsin are qualified health care providers that are fully covered for losses in excess of statutory limits through mandatory participation in the State of Wisconsin Injured Patients and Families Compensation Fund. In addition, various umbrella insurance policies have been purchased to provide coverage in excess of the self-insured limits. Revocable trust funds, administered by a trustee and a captive insurance company, have been established for the self-insurance programs. Actuarial consultants have been retained to determine the estimated cost of claims, as well as to determine the amount to fund into the irrevocable trust and captive insurance company.

The estimated cost of claims is actuarially determined based on past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. Accrued insurance liabilities and contributions to the trust were determined using a discount rate of 3.00% as of June 30, 2019 and December 31, 2018.

The System entities are defendants in certain litigation related to professional and general liability risks, and other matters. Although the outcome of the litigations cannot be determined with certainty, management believes, after consultation with legal counsel, that the ultimate resolution of the litigations will not have a material adverse effect on the System's operations or financial condition.

15. LEGAL, REGULATORY AND OTHER CONTINGENCIES

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. During the last few years, due to nationwide investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, exclusion from the Medicare and Medicaid programs and revocation of federal or state tax-exempt status. Moreover, the System expects that the level of review and audit to which it and other health care providers are subject will increase.

Various federal and state agencies have initiated investigations, which are in various stages of discovery, relating to reimbursement, billing practices and other matters of the System. There can be no assurance that regulatory authorities will not challenge the System's compliance with these laws and regulations, and it is not possible to determine the impact, if any, such claims or penalties would have on the System. To foster compliance with applicable laws and regulations, the System maintains a compliance program designed to detect and correct potential violations of laws and regulations related to its programs.

16. ACQUISITION OF BAY AREA MEDICAL CENTER

On April 1, 2019, the System acquired the remaining 51% interest in BAMC. The acquisition will improve the availability, scope and access to health care in the communities served by BAMC. As of April 1, 2019, BAMC and ABAMG are fully consolidated within the condensed consolidated financial statements of the System. Prior to April 1, 2019, the System had a 49% interest in BAMC and a 27% interest of ABAMG.

In conjunction with the BAMC transaction, the System contributed $25,000 to the M&M Foundation, a newly formed foundation. This interest in the M&M Foundation is reflected in investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. Under the terms of the definitive agreement between the System and BAMC, the use of the $25,000 contribution is designated to support the operations and capital needs of BAMC and/or ABAMG.

As the System previously had an interest in BAMC, this transaction was accounted for as a step acquisition. The System remeasured its previously held equity interest in BAMC to fair market value resulting in a gain of $44,400 which is recorded within nonoperating income on the condensed consolidated statements of operations and changes in net assets. The System then recorded its 100% interest in BAMC at fair market value resulting in an inherent contribution of $44,200 which is recorded within nonoperating income on the condensed consolidated statements of operations and changes in net assets.

The preliminary fair value of assets and liabilities of BAMC acquisition at April 1, 2019 consisted of the following:

Current assets	$	37,269
Assets limited as to use		18,795
Property and equipment		160,100
Other noncurrent assets		6,152
Other intangible assets		460
Total assets	$	222,776
Current liabilities		19,590
Long-term debt, less current portion		78,959
Other noncurrent liabilities		6,639
Total liabilities		105,188
Net assets with donor restrictions		792
Net assets without donor restrictions		116,796
Total liabilities and net assets	$	222,776

This preliminary fair value estimate will be revised during 2019 as additional information related to the fair value of BAMC's assets and liabilities as of April 1, 2019 is finalized.

Total revenue and operating loss from the date of acquisition for BAMC of $37,313 and $(1,450), respectively were included in the condensed consolidated statements of operations and changes in net assets. The BAMC related changes in net assets without donor restrictions of $2,800 from the date of acquisition is included in the condensed consolidated balance sheets.

The proforma financial statements presented below were prepared on a consolidated basis utilizing the accounting records of the System and BAMC as if the acquisition had occurred for the entirety of the periods presented. The proforma presented have been adjusted to eliminate activity between the System and BAMC. Management believes the assumptions underlying the proforma financial statements presented, including the assumptions regarding the elimination of inter-company activity are reasonable. Nevertheless, the proforma statements may not reflect the results of operations had BAMC had been a combined company during the periods presented and is not intended to project the System's results of operations for any future periods.

	Six Months Ended June 30, 2019	**Nine Months Ended December 31, 2018**
Total revenue	$ 6,258,687	$ 9,295,172
Operating income	244,745	415,350
Revenues in excess of expenses	1,031,325	74,447

17. SUBSEQUENT EVENTS

The System evaluated events and transactions subsequent to June 30, 2019 through August 21, 2019, the date of financial statement issuance.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL POSITION

This quarterly report includes the condensed consolidated financial statements and analysis for Advocate Aurora Health, Inc., a Delaware nonprofit corporation ("the Parent Corporation"), and its subsidiaries. References to "the System", "we", "our", or "us" in this document are to the Parent Corporation and all of the subsidiaries consolidated with it pursuant to accounting principles generally accepted in the United States of America ("GAAP"). References to the Parent Corporation are references only to the Parent Corporation and should not be read to include any of the Parent Corporation's and subsidiaries.

The following proforma financial statements for the six months ended June 30, 2018, included within this quarterly report were prepared on a consolidated basis utilizing accounting records of Advocate Health Care Network and Subsidiaries ("Advocate") and Aurora Health Care, Inc., and Affiliates ("Aurora") as if the System had been operating as a combined company for the periods presented. These financial statements have been prepared in accordance with GAAP. The System's revenues and expenses have been adjusted to include a previously non-consolidated lab joint venture ("A2CL") as well as associated eliminations of activity and balances due between Advocate and Aurora. Additionally, certain accounting policies have been adjusted to align Advocate and Aurora within the proforma statements presented. Management believes the assumptions underlying the proforma financial statements presented, including the assumptions regarding the elimination of inter-company activity and accounting policy changes are reasonable. Nevertheless, the proforma statements may not reflect the results of operations had the System been a combined company during the periods presented and is not intended to project the System's results of operations for future periods.

The financial information should be read together with our condensed consolidated financial statements and related notes included elsewhere in this quarterly report, as well as the audited consolidated financial statements of the System as of and for the nine months ended December 31, 2018, which is available from the Municipal Securities Rulemaking Board (the MSRB) on its Electronic Municipal Market Access ("EMMA") system, found at http://emma.msrb.org. Additional information can be found on the investor relations section of the System's website at https://www.advocateaurorahealth.org/investor-relations.

Certain statements included in this quarterly report constitute forward-looking statements that involve risks and uncertainties. Actual results may differ significantly from the results discussed in the forward-looking statements as a result of known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. We do not plan to issue any updates or revisions to those forward-looking statements if or when the expectations, or events, conditions or circumstances on which such statements are based occur.

ADVOCATE AURORA HEALTH, INC.
KEY FINANCIAL RATIOS

	Three Months Ended,	
	June 30, 2019	June 30, 2018
Profitability		
Operating margin[1]	5.7%	4.1%
Operating cash flow margin[2]	11.0%	9.5%
Excess Margin[3]	12.0%	5.2%
EBIDA margin[4]	18.3%	10.7%

	Six Months Ended,	
	June 30, 2019	June 30, 2018[A]
Profitability		
Operating margin[1]	5.1%	4.3%
Operating cash flow margin[2]	10.4%	9.8%
Excess margin[3]	14.7%	4.7%
EBIDA margin[4]	21.8%	10.2%

	As of June 30, 2019	As of December 31, 2018
Leverage and Liquidity		
Debt to capitalization[5]	21.4%	23.1%
Cash to debt[6]	267%	252%
Days cash on hand[7]	257	247

[A] - See previous discussion of the preparation of proforma financial statements.

Profitability
[1] Operating income before nonrecurring expenses/Total revenue
[2](Operating income before nonrecurring expenses + Interest + Depreciation and amortization)/Total revenue
[3] Revenue in excess of expenses/(Total revenue + Total nonoperating income, net)
[4](Revenue in excess of expenses + Interest + Depreciation and amortization)/Total revenue

Liquidity
[5](Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion)/ (Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion + Total net assets without donor restrictions)
[6]Unrestricted cash and investments /(Current portion of long-term debt and commercial paper+ Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion)
[7]Unrestricted cash and investments/(Total expenses - Depreciation and amortization + Nonrecurring expenses)/days in period). The days cash on hand ratio is calculated from expenses for the six months ended June 30, 2019 and the twelve months ended December 31, 2018.

ADVOCATE AURORA HEALTH, INC.
HISTORICAL UTILIZATION

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Change	% Change
Discharges	68,346	69,584	(1,238)	(1.8)%
Observation Cases	26,993	24,658	2,335	9.5 %
Outpatient Visits	1,287,074	1,152,238	134,836	11.7 %
Physician Visits	2,501,346	2,301,655	199,691	8.7 %
Home Care Visits	199,814	204,975	(5,161)	(2.5)%
Capitated Member Lives(1)	289,457	321,316	(31,859)	(9.9)%

	Six Months Ended June 30, 2019	Proforma Six Months Ended June 30, 2018	Change	% Change
Discharges	135,209	140,365	(5,156)	(3.7)%
Observation Cases	51,973	48,188	3,785	7.9 %
Outpatient Visits	2,408,121	2,290,247	117,874	5.1 %
Physician Visits	4,788,678	4,619,416	169,262	3.7 %
Home Care Visits	394,088	389,772	4,316	1.1 %

(1) As of the date set forth in the column header

ADVOCATE AURORA HEALTH, INC.

PROFORMA CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(dollars in thousands)

	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018[1]
Revenue		
Patient service revenue	$ 5,200,076	$ 4,902,877
Capitation revenue	636,482	653,771
Other revenue	394,249	381,690
Total revenue	6,230,807	5,938,338
Expenses		
Salaries, wages and benefits	3,401,172	3,216,057
Supplies and purchased services	1,548,616	1,470,842
Contracted medical services	264,292	296,187
Other	371,135	376,248
Depreciation and amortization	276,351	270,877
Interest	54,584	53,346
Total expenses	5,916,150	5,683,557
Operating income before nonrecurring expenses	314,657	254,781
Nonrecurring expenses	69,543	33,995
Operating income	245,114	220,786
Nonoperating income		
Investment income, net	699,026	35,641
Change in fair value of interest rate swaps	(20,648)	12,565
Other nonoperating income, net	104,227	12,460
Total nonoperating income, net	782,605	60,666
Revenue in excess of expenses	1,027,719	281,452
Less noncontrolling interest	(26,751)	(22,880)
Revenue in excess of expenses - attributable to controlling interest	$ 1,000,968	$ 258,572

[1] See previous discussion of the preparation of proforma financial statements.

MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS
(dollars in thousands)

The management discussion and analysis section refers to the condensed consolidated statements of operations.

Results of Operations – Three Months Ended June 30, 2019 Compared to Three Months Ended June 30, 2018

Operating income before nonrecurring expenses was $183,437 for the three months ended June 30, 2019, resulting in an operating margin of 5.7%, compared to operating income before nonrecurring expense of $121,786 for the three months ended June 30, 2018, resulting in an operating margin of 4.1%. Nonrecurring expenses of $51,102 and $14,545 for the three months ended June 30, 2019 and 2018, respectively, consisted of costs in connection with the formation of the System, the implementation of an electronic medical records and billing system, the implementation of an enterprise resource planning system and, as part of the initiative to reduce operating expenses, an early retirement incentive program.

Patient service revenue increased $216,661 (8.8%) in the three months ended June 30, 2019, compared to the same period in the prior year. Patient service revenue increased primarily due to increased outpatient visits and patient acuity over the comparative period. The increase was also driven by the conversion of a full risk capitation agreement to a fee-for-service arrangement in 2019. Additionally, the acquisition of BAMC increased patient service revenue $32,191 over the comparative period. See discussion of this transaction within Note 16. ACQUISITION OF BAY AREA MEDICAL CENTER.

Capitation revenue decreased $25,209 (7.6%) in the three months ended June 30, 2019, compared to the same period in the prior year due to a decrease in capitated lives of 9.9%. The decrease in capitated lives is largely driven by the conversion of a full risk arrangement to a fee-for-service arrangement, as result, the revenue generated from this plan is now included within patient service revenue.

Salaries, wages and benefits increased $124,674 (7.7%) in the three months ended June 30, 2019, compared to the same period in the prior year. The increase in salaries, wages and benefits is due to an increase in full time equivalents ("FTE's"), merit salary increases and an increase in benefit expense due to higher claim experience associated with employee health plans. Additionally, the acquisition of BAMC increased salaries, wages and benefits $13,516 over the comparative period. See discussion of this transaction within Note 16. ACQUISITION OF BAY AREA MEDICAL CENTER.

Supplies and purchased services increased $37,933 (5.0%) in the three months ended June 30, 2019, compared to the same period in the prior year primarily due to increases in outpatient volumes. Supplies and purchased services as a percentage of total revenue excluding capitation revenue decreased from 28.4% to 27.5%.

Contracted medical services expense decreased $33,980 (22.1%) in the three months ended June 30, 2019, compared to the same period in the prior year primarily due the conversion of a full risk capitation arrangement to a fee-for-service arrangement in 2019. The conversion of this plan resulted in a reduction of contracted medical services expense.

Nonrecurring expense increased $36,557 in the three months ended June 30, 2019, compared to the same period in prior year primarily related to the ongoing implementation of an electronic medical records and billing system and the early retirement incentive program offered as part of the System's efforts to reduce costs.

Nonoperating income increased $234,575 for the three months ended June 30, 2019, compared to the same period in the prior year. Nonoperating income increased primarily as a result of investment income, net which increased $149,594 over the comparative period. See disclosure of the composition of investment income, net within Note 4. INVESTMENTS. The increase in investment income is due to an improvement in the financial markets over the comparative period. The change in the fair value of interest rate swaps is attributable to the change in interest rates. Other nonoperating income, net increased $102,617 primarily due to gains related to the acquisition of BAMC as outlined within Note 16. ACQUISITION OF BAY AREA MEDICAL CENTER.

Overall, the System reported an excess of revenue over expenses of $418,373 for the three months ended June 30, 2019, which compared favorably to an excess of revenue over expenses of $158,704 for the three months ended June 30, 2018.

The management discussion and analysis section for the six months ended June 30 are based on the proforma condensed consolidated statements of operations. The proforma information should not be construed to accurately reflect what the actual results would have been had the formation of the System been consummated as of the comparative periods presented in 2018.

Results of Operations – Six Months Ended June 30, 2019 Compared to Six Months Ended June 30, 2018

Operating income before nonrecurring losses was $314,657 for the six months ended June 30, 2019, resulting in an operating margin of 5.1%, compared to operating income of $254,781 for the six months ended June 30, 2018, resulting in an operating margin of 4.3%. Nonrecurring losses of $69,543 and $33,995 for the six months ended June 30, 2019 and 2018, respectively, consisted of costs in connection with the formation of the System, the implementation of an electronic medical records and billing system, the implementation of an enterprise resource planning system and, as part of the initiative to reduce operating expenses, an early retirement incentive program.

Patient service revenue increased $297,199 (6.1%) in the six months ended June 30, 2019, compared to the same period in the prior year. Patient service revenue increased primarily due to an increase in outpatient visits and patient acuity over the comparative period. The increase was also driven by the conversion of a full risk capitation agreement to a fee-for-service arrangement in 2019. Additionally, the acquisition of BAMC increased patient service revenue $32,191 over the comparative period. See discussion of this transaction within Note 16. ACQUISITION OF BAY AREA MEDICAL CENTER.

Salaries, wages and benefits increased $185,115 (5.8%) in the six months ended June 30, 2019, compared to the same period in the prior year. The increase in salaries, wages and benefits is due to an increase in FTE's and an increase in benefit expense due to higher claim experience associated with employee health plans. Additionally, the acquisition of BAMC increased salaries, wages and benefits $13,516 over the comparative period. See discussion of this transaction within Note 16. ACQUISITION OF BAY AREA MEDICAL CENTER.

Supplies and purchased services increased $77,774 (5.3%) in the six months ended June 30, 2019, compared to the same period in the prior year primarily due to an increase in outpatient volumes and patient acuity. For the six months ended June 30, 2019 and 2018, supplies and purchased services expense as a percent of total revenue less capitation revenue was 27.7% and 27.8%, respectively.

Contracted medical services expense decreased $31,895 (10.8%) in the six months ended June 30, 2019, compared to the same period in the prior year primarily due to the conversion of a full risk capitation arrangement to a fee-for-service arrangement in 2019.

Nonrecurring expense increased $35,548 in the six months ended June 30, 2019, compared to the same period in prior year primarily related to the ongoing implementation of an electronic medical records and billing system and the early retirement incentive program offered as part of the System's efforts to reduce costs.

Nonoperating income increased $721,939 for the six months ended June 30, 2019, compared to the same period in the prior year, primarily due to investment income, net which increased $663,385 over the comparative period. See disclosure of the composition of investment income, net within Note 4. INVESTMENTS. The increase in investment income is due to an improvement in the financial markets over the comparative period. The change in fair value of interest rate swaps is attributable to the change in interest rates. Other nonoperating income, net increased $91,767 primarily due to the acquisition of BAMC as outlined within Note 16. ACQUISITION OF BAY AREA MEDICAL CENTER.

Overall, the System reported an excess of revenue over expenses of $1,027,719 for the six months ended June 30, 2019 compared to $281,452 for the six months ended, June 30, 2018.

Liquidity

The System holds substantially all of its' investments in a single investment portfolio. The investments in this portfolio are managed by external investment professionals under the guidelines set out in the investment policy statement adopted by the System's Board.

This policy includes the target allocations for the System investment program. The System’s investment program’s target asset allocation, excluding cash and cash equivalents maintained for operating purposes, provides for a commitment to equity securities (30%), fixed income investments (20%), and select alternative investment classes (50%). Limitations are placed on investment managers as to the overall amount that can be invested in one issuer (except for U.S. government obligations and its agencies) or economic sector. See disclosure of the composition of the System's investment assets within NOTE 5. FAIR VALUE.

Investment income (including both realized and unrealized gains on investments) significantly impacts the System’s financial results. Market fluctuations have affected and will likely continue to materially affect the value of those investments and those fluctuations may be and historically have been material. Reduction in investment income, or realized and unrealized losses, and the market value of its investments may have a negative impact on the System’s financial condition, including its ability to provide its own liquidity for variable rate debt or to fund capital expenditures from cash and investments.

The System's financing strategy is to ensure liquidity and access to capital markets, to maintain a balanced spectrum of debt maturities, and to manage our net exposure to floating interest rate volatility. Within these parameters, we seek to minimize our borrowing costs. Our ability to access the long-term debt and commercial paper markets has provided us with ample sources of liquidity. At any given time, Management has granted authorization by the System's Board of Directors to issue commercial paper and/or have lines of credit in place up to a combined maximum of $700,000.

Days Cash on Hand

Days cash on hand was 257 as of June 30, 2019 compared to 247 as of December 31, 2018. The increase in days cash on hand is primarily due to strong investment returns during 2019.

Indebtedness

<u>Master Indenture Obligations</u>: In August 2018, the System issued $1,202,395 in aggregate principal amount of bonds (the "Series 2018 Bonds") to refinance certain tax-exempt bonds issued by WHEFA in the aggregate principal amount of $941,295, taxable bonds in the aggregate principal amount of $208,555 and the drawn portion of a line of credit in the amount of $58,500. The Series 2018 Bonds, as well as substantially all other outstanding bonds and certain other obligations to lenders, banks and swap counterparties are now all secured under the Second Amended and Restated Master Trust Indenture dated as of August 1, 2018, with the Members

of the Obligated Group and U.S. Bank National Association, as master trustee (the "Advocate Aurora Master Indenture").

In connection with the BAMC acquisition, the System assumed $81,465 of tax-exempt bonds issued by WHEFA which are held by a bank through a direct purchase agreement. Through a note substitution, this debt is secured under the Advocate Aurora Master Indenture.

Under the terms of the bond indentures and other arrangements, various amounts are to be on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The Advocate Aurora Master Indenture and other debt agreements, including bank credit agreements, also place restrictions on the System to maintain certain financial ratios. Each of the bank agreements requires various reporting, operating and financial covenants to be maintained. These covenants may be waived, modified or amended by the related bank in its sole discretion and without notice to or consent by any bond trustee, the Master Trustee or the holders of any outstanding bonds. Violation of any such covenants may result in an Event of Default under the Advocate Aurora Master Indenture, which could result in acceleration of all Obligations issued under the Advocate Aurora Master Indenture.

The System's total long-term debt and commercial paper was as follows:

	June 30, 2019	December 31, 2018
Tax-exempt bonds	$ 1,952,619	$ 1,942,948
Taxable bonds	709,510	709,392
Financing arrangements	207,977	241,677
Taxable term loan	114,855	114,841
Commercial paper	50,000	—
Total long-term debt	$ 3,034,961	$ 3,008,858

Standby Bond Purchase Agreements ("SBPA"): The System is a party to three SBPAs with two banks to provide liquidity support for the three subseries of the Series 2008C Bonds in the event of a failed remarketing of any such Series 2008C Bonds. The termination dates of the SBPAs are as follows:

Subseries	Par	Expiration
2008C-1	$ 129,500	1/15/2024
2008C-2B	58,200	8/15/2021
2008C-3A	87,700	8/15/2021
Total	$ 275,400	

In the event any bonds are not remarketed within one year from the date they are purchased by a bank pursuant to an SBPA ("Bank Bonds"), the System has agreed to cause such Bank Bonds to be redeemed pursuant to the related bond indenture such that the unpaid principal balance of all outstanding Bank Bonds shall amortize in approximately equal quarterly installments, with the first installment commencing on the date that is one year and one day after the date on which such Series 2008C Bond became a Bank Bond, the final installment payable on the date that is five years from the date on which such Series 2008C Bond became a Bank Bond (or, with respect to any Series 2008C-1 Bond that is a Bank Bond, if earlier, the date that is one year and one day following the then current Stated Expiration Date which is January 15, 2024). At June 30, 2019, there were no Bank Bonds outstanding.

Covenant Agreements ("CAs"): The System is party to CAs with a bank, related to the $50,000 Series 2011C Bonds and $50,000 Series 2011D Bonds issued in September 2011 and purchased by the bank. The Series 2011C Bonds and Series 2011D Bonds currently bear interest at an indexed rate until September 3, 2024. At the end of their initial periods, the Series 2011C Bonds and the Series 2011D Bonds will be subject to mandatory tender, unless waived by the holders thereof, and the System presently anticipates that the Series 2011C Bonds and Series 2011D Bonds will be remarketed to new holders in one of the interest rate modes available under the related bond indenture. In the event the Series 2011C Bonds or the Series 2011D Bonds are not remarketed on their respective mandatory tender dates, then, as long as no default or event of default (as defined in the CAs) has occurred and is continuing, the Series 2011C Bonds or Series 2011D Bonds, as applicable, may either be repaid over a three-year period or remarketed during that time.

The System is party to a CA with a bank related to the Bay Area Series 2015A Bonds and Bay Area Series 2015B Bonds (the “Bay Area Bonds”) with par outstanding at June 30, 2019 in the amount of $38,060 and $43,405, respectively. The Series 2015A Bonds currently bear interest at a fixed rate and the Series 2015B Bonds currently bear interest at an indexed rate until December 17, 2022. At the end of the initial period the Bay Area Bonds will be subject to mandatory tender, unless waived by the holders thereof. In the event that the Bay Area Bonds are not remarketed on their mandatory tender dates, then, as long as no default or event of default as defined in the CA has occurred and is continuing, the Bay Area Bonds may be repaid in six equal quarterly installments or remarketed during that time.

Windows Variable Rate Bonds: The System's Series 2011B Bonds bear interest at Windows Interest Rates (the "Windows Variable Rate Bonds") and are subject to optional and mandatory tender for purchase. The Windows Variable Rate Bonds are not supported by any external dedicated liquidity facility. Holders of Windows Variable Rate Bonds have a right to optionally tender their Bonds for purchase. If the tendered Windows Variable Rate Bonds are not successfully remarketed within the 30-day period that follows the date that notice of such optional tender is received by the Remarketing Agent (the "Remarketing Window"), then all Windows Variable Rate Bonds are required to be purchased on the day that is 210 days after notice of such optional tender is received by the Remarketing Agent (the "Windows Mandatory Tender Date"). The period from the end of the Remarketing Window until the Windows Mandatory Tender Date (initially, 180 days) is referred to as the Funding Window. During the Funding Window, the System expects that it would analyze the then current market conditions, availability and relative cost of any refinancing or restructuring alternatives for those Windows Variable Rate Bonds that are required to be purchased on the Windows Mandatory Tender Date (including, without limitation, conversion of those bonds to another interest mode or the refinancing or repayment of those bonds). The Windows Variable Rate Bonds are classified as current liabilities at June 30, 2019 and December 31, 2018 in the condensed consolidated balance sheets because these bonds may be subject to tender on a date that was within one year of the balance sheet date.

Long-term Rate Bonds: The Series 2003A, Series 2003C, Series 2008A-1, Series 2008A-2, Series 2008A-3, Series 2018B-1, Series 2018B-2, Series 2018B-3 and Series 2018B-4 Bonds (the "Long Term Rate Bonds") were originally issued as long-term rate bonds. The Series 2003A Bonds, Series 2003C Bonds and 2008A-3 Bonds are in long-term rate periods that extend to their respective maturity dates, which is November 15, 2022 for the Series 2003A and Series 2003C Bonds and November 1, 2030 for the Series 2008A-3 Bonds. The Long Term Rate Bonds bear interest at long-term rates for a particular interest rate period and are subject to mandatory tender at the end of each particular interest rate period.

The following table summarizes the next scheduled mandatory tender dates for certain of the Long Term Rate Bonds as of June 30, 2019, and excludes those Long Term Rate Bonds that mature on their mandatory tender date. In the event these Long Term Rate Bonds are not remarketed upon mandatory tender at the end of their current interest rate period, management anticipates utilizing marketable unrestricted investments, commercial paper issuance and/or available lines of credit to meet the purchase obligations.

Subseries		Par	Expiration
Series 2008A-1		42,045	1/15/2020
Series 2008A-2		35,490	2/12/2020
Series 2018B-1		46,690	1/26/2022
Series 2018B-2		46,310	1/25/2023
Series 2018B-3		48,560	1/31/2024
Series 2018B-4		49,420	1/29/2025
Total	$	268,515	

The Series 2008A-3 Bonds were subject to mandatory tender on May 1, 2019 (the "2019 Mandatory Tender Date"). The Series 2008A-3 Bonds were classified as current liabilities as of December 31, 2018 in the condensed consolidated balance sheets as these bonds were subject to mandatory tender on a date that was within one year of the balance sheet date. While $42,795 of the Series 2008A-3 Bonds were outstanding on the 2019 Mandatory Tender Date, only $36,535 of the Series 2008A-3 Bonds were remarketed. The reduction in the principal amount reflects the application of the premium paid on the Series 2008A-3 Bonds upon their remarketing, together with other funds, to the retirement of $6,260 of the Series 2008A-3 Bonds on the 2019 Mandatory Tender Date. The Series 2008A-3 Bonds will next be subject to mandatory tender on November 1, 2030, which is also the maturity date for the Series 2008A-3 Bonds.

Indexed Floating Rate Bonds: The Series 2018C-1 Bonds, Series 2018C-2 Bonds, Series 2018C-3 Bonds and Series 2018C-4 Bonds (collectively the "2018C Bonds") bear interest at an indexed rate. At the end of their initial index rate periods, the Series 2018C Bonds will be subject to mandatory tender. The System presently anticipates that the Series 2018C Bonds will be remarketed to new holders in one of the interest rate modes available under the related bond indentures. The following table summarizes the next scheduled mandatory tender dates for these bonds.

Subseries		Principal Amount	Next Mandatory Tender date
Series 2018C-1	$	50,000	7/28/2021
Series 2018C-2		50,000	7/27/2022
Series 2018C-3		49,065	7/26/2023
Series 2018C-4		50,350	7/31/2024
Total	$	199,415	

Taxable Term Note: The System is party to a taxable term loan agreement with a bank, relating to a $114,855 term loan, the proceeds of which were used to defease a portion of the Series 2010 Bonds. Absent an agreement between the System and the bank to extend the final maturity, the taxable term loan matures on August 27, 2024.

Commercial Paper: In order to enhance the System's liquidity, Management has the authority to issue up to $475,000 from time to time under the System's commercial paper program. On March 5, 2019, the System issued commercial paper in the amount of $50,000. The proceeds of the commercial paper were used to redeem the Series 2008C-2A bonds of $49,230 plus accrued interest and certain costs related to the issuance of the commercial paper. The remaining proceeds were used for general corporate purposes. The standby bond purchase agreement related to the Series 2008C-2A bonds was cancelled effective March 5, 2019.

Lines of Credit: At June 30, 2019, the System had a $100,000 line of credit, under which letters of credit can also be issued, bearing interest at the commercial bank floating rate or LIBOR plus a spread, based upon the option of the System. At June 30, 2019, letters issued under the line of credit totaling $46,773 were outstanding. At June 30, 2019, there were no outstanding draws on the line of credit or letters of credit. This line of credit is secured by an Obligation issued under the Advocate Aurora Master Indenture.

At June 30, 2019, the System had lines of credit with banks totaling $225,000, including the $100,000 line of credit described above. No amounts were outstanding on these lines of credit as of June 30, 2019. Each line of credit is secured by an Obligation issued under the Advocate Aurora Master Indenture.

Under regulatory rules of the State of Illinois, Advocate is required to post a letter of credit or surety bond with a State Agency, Advocate held a surety bond in the amount of $16,975. No amounts were drawn on this surety bond at June 30, 2019.

Other Indebtedness: At June 30, 2019, the System had various finance lease arrangements totaling $207,977 classified as long-term debt. These arrangements, which relate to various administrative and medical support buildings, had initial lease terms of 15 to 25 years.

Interest Rate Swaps: The System entered into multiple floating-to-fixed interest rate swap arrangements with respect to the Series 2008C Bonds (collectively, the Series 2008C Swaps) pursuant to ISDA Master Agreements. Pursuant to the Series 2008C Swaps, Well Fargo Bank, National Association ("Wells Fargo") and PNC Bank, National Association ("PNC") pay the System the sum of a percentage of the one-month London Interbank Offered Rate ("LIBOR") plus a spread, and the System pays Wells Fargo and PNC amounts based on a fixed rate (approximately 3.605%). All Wells Fargo, PNC and the System payments are made on a same day net payment basis with reference to a notional amount that declines over the term of the Series 2008C Swaps. Unless terminated earlier in accordance with their terms, the Series 2008C Swaps' scheduled termination date is November 1, 2038. Under certain circumstances; however, the Series 2008C Swaps are subject to termination prior to the scheduled termination date.

In connection with the BAMC acquisition, the System acquired an interest rate swap. BAMC had entered into a floating-to-fixed interest rate swap agreement (“Bay Area Swap”) pursuant to an ISDA Master Agreement. Piper Jaffray Financial Products Inc. (“Piper Jaffray”) pays BAMC a percentage of the one-month LIBOR and BAMC pays Piper Jaffray amounts based on a fixed rate (approximately 3.314%) based on the notional amount which declines over the term of the Bay Area Swap. Unless terminated earlier in accordance with their terms, the Bay Area Swap’s scheduled termination date is February 1, 2038. Under certain circumstances, the Bay Area Swap is subject to termination prior to the scheduled termination date.

See Note 5. FAIR VALUE and Note 10. INTEREST RATE SWAP PROGRAM for discussion of the fair value and a description of the accounting treatment of the System's interest rate swap arrangements.

Securities Lending: As part of the management of the investment portfolio, the System has entered into an arrangement whereby securities owned by the System are loaned, primarily to brokers and investment banks. The loans are arranged through a bank. Borrowers are required to post collateral in the form of cash or highly rated securities for securities borrowed equal to no less than 102% of the value of the security loaned on a daily basis. The bank is responsible for reviewing the credit-worthiness of the borrowers. The System has also entered into an arrangement whereby the bank is responsible for the risk of borrower bankruptcy and default. At June 30, 2019 and December 31, 2018, the System loaned approximately $12,173 and $18,310, respectively in securities and accepted collateral for these loans in the amount of $12,819 and $18,869, respectively which represented cash and government securities. The collateral received under the securities lending program has been reflected as a current asset and a current obligation payable in the condensed consolidated balance sheets presented. The balance of securities loaned and accepted collateral fluctuates daily.

Capital Expenditures

For the six months ended June 30, 2019, capital expenditures of the System were $289,982; at June 30, 2019 the System had $346,770 in construction-in-progress. The amounts in construction-in-progress at June 30, 2019 relate to various projects to improve existing facilities and expand access to health care in the markets served.

The System is intending to build a hospital and medical office building on a site along the I-94 corridor in Mount Pleasant, Wisconsin. The System expects the hospital, medical office building and ancillary buildings to cost approximately $250,000, with construction estimated be completed in 2021. Also, the System is building a medical campus in Sheboygan, Wisconsin. The cost is expected to be approximately $325,000 with an expected completion date in 2022. Additionally in October 2018, the System broke ground on an ambulatory surgery center and medical office building project in the Kenosha/Pleasant Prairie, Wisconsin area. The cost is expected to be approximately $130,000 with an expected completion date in 2020. Currently, management expects to fund capital commitments and expenditures with cash generated from operations and investment income, as well as from existing cash and investment balances.

LEGAL AND REGULATORY COMPLIANCE

The System operates in a highly litigious industry. As a result, various lawsuits, claims and proceedings have been instituted or asserted against it from time to time. The System has knowledge of certain pending suits against certain of its entities that have arisen in the ordinary course of business. In the opinion of management, the System maintains adequate insurance and/or other financial reserves to cover the estimated potential liability for damages in these cases, or, to the extent such liability is uninsured, adverse decisions will not have a material adverse effect on the financial position or operations of the System.

As a health care provider, the System entities are subject to extensive and frequently changing federal, state and local laws and regulations governing various aspects of our business. In particular, the System entities provide a broad range of services, many of which are regulated by different government agencies, subject to differing regulatory schemes and subject to contractual reviews and program audits in the normal course of business. Many operations that the System entities undertake are subject to significant governmental certification and licensing regulations, as well as federal and state laws.

The System, like all major health care systems, periodically may be subject to investigations or audits by federal, state and local agencies involving compliance with a variety of laws and regulations. These investigations seek to determine compliance with, among other things, laws and regulations relating to Medicare and Medicaid reimbursement, including billing practices for certain services. Violation of such laws could result in substantial monetary fines, civil and/or criminal penalties and exclusion from participation in Medicare, Medicaid or similar programs.

Compliance and Internal Audit Programs

The System's Compliance and Integrity Program ("Program") is overseen by the System Chief Compliance Officer. The System Chief Compliance Officer reports to the System Chief Integration Officer, who is a direct report to the CEO, with reporting accountability to the Audit and Compliance Committee of the System Board of Directors. The Program is modeled after the seven essential elements of an effective compliance program, as set forth in the U.S. Health and Human Services, Office of Inspector General Compliance Program Guidance and further interpreted by the Federal Sentencing Guidelines and the U.S. Department of Justice Guidelines for the Federal Prosecution of Corporations. The Program includes mandatory annual education of all employees regarding specific legal and regulatory requirements applicable to health care organizations, including requirements related to patient confidentiality, information privacy, information systems security, conflicts of interest, licensure and certification, federal fraud and abuse laws, billing, coding and documentation, civil rights and non-retaliation. The Program is based on a Code of Conduct and includes an anonymous hotline available to report violations or seek guidance on compliance issues.

The System also has an internal audit department responsible for providing independent and objective assurance and consulting services designed to add value and help the System accomplish its objectives by bringing a systematic, disciplined approach to evaluate the effectiveness of risk management, control and governance processes. The System Audit Officer reports functionally to the Audit and Compliance Committee of the Board of Directors and administratively to the Chief Financial Officer. The internal audit department carries out an annual audit program that assesses the System's design and operation of internal controls to achieve efficient and effective operations, accurate and reliable financial reporting, compliance with policies, laws and regulations and the proper safeguarding of assets.

BOND RATINGS

In August 2018, in connection with a refinancing of debt ratings were obtained for all of the System’s debt. Fitch assigned a rating of AA (stable outlook), S&P assigned a rating of AA (stable outlook) and Moody’s assigned a rating of Aa3 (stable outlook).

In March 2019, Fitch assigned its F1+ short-term rating and S&P assigned its A-1+ short-term rating to the System's series 2019 taxable commercial paper notes, authorized for up to $475,000.

Additional information on the System's bond ratings can be obtained from the Investor Relations section on https://www.advocateaurorahealth.org/investor-relations.

MANAGEMENT

As part of the formation of the System an executive leadership team was appointed. Key members of the management of the System are described within the "GOVERNANCE AND MANAGEMENT" section in Appendix A to the Official Statement dated August 16, 2018, relating to the Series 2018 Bonds (the "Official Statement"). The Official Statement can be accessed from the MSRB on its EMMA system, found at http://emma.msrb.org.

Joyce Rodgers was appointed as the System's Chief Government Relations Officer effective April 8, 2019.

Jim Skogsbergh was named the sole President and CEO of the System as of July 24, 2019. Upon this appointment Nick Turkal, M.D., CEO has resigned from the System.

SYSTEM STRATEGY

In February 2019, the System’s Board of Directors approved the Transformation 2025 Strategic Plan (“Plan”). The Plan’s goal is to ensure the System is well positioned for a strong and healthy future to help people live well. The Plan is designed to transform the System into a destination, which connects consumers to all aspects of their health and wellness. The Plan is a guide, which addresses dual and parallel paths-one focused on who the System is today, while the other is simultaneously focused on who the System will become tomorrow. The System will be transforming how the System is currently delivering traditional health care in its relentless pursuit of safety, health outcomes, growth and affordability. And at the same time, the System is on a journey toward Destination Health - a wellness ecosystem that connects consumers to all aspects of their health and wellness, with the consumer- front and center -connecting both paths. Strategies of the plan focus on safety, health outcomes, growth, financial strength, consumer experience, new consumer businesses, culture and a destination health platform.

INDUSTRY RISKS

The “BONDHOLDERS’ RISKS” section in Appendix A to the Official Statement included a description of several lawsuits that were ongoing in Illinois related to property tax exemption for not for profit hospitals, including challenges to constitutionality of the Illinois Property and Sales Tax Act. In September 2018, the Illinois Supreme Court upheld the constitutionality of the Illinois Property and Sales Tax Act.

In February 2019, Senator Chuck Grassley, Chairman of the Senate Finance Committee, sent the IRS Commissioner a letter seeking additional information on the agency’s enforcement of the tax-exemption requirements applicable to charitable hospitals. The letter follows a similar request sent by the Senator in 2018 and expands the scope of the inquiry. The new questions indicate that lawmakers continue to closely monitor IRS examination and enforcement activity relating to tax-exempt hospitals.

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