



## Fairview Health Services

Continuing Disclosure Statement  
for the Year Ended December 31, 2017

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*Note: The attached information is provided for the benefit of registered or beneficial bondholders and other issuers of credit and credit enhancement to Fairview Health Services and the Fairview Obligated Group. Questions and/or requests for additional information should be directed to Kimberly Faust, Vice President and Treasurer at: [kfaust1@fairview.org](mailto:kfaust1@fairview.org). Additional information about Fairview can be found at: [www.fairview.org](http://www.fairview.org).*

## **Section One – Overview of Fairview Health Services**

## GENERAL

Fairview Health Services (“Fairview”) located in Minneapolis, Minnesota, an integrated health system, along with its affiliates and subsidiaries (collectively the “Fairview System”) is one of the leading health care providers in Minnesota with nearly \$5.3 billion in operating revenue for 2017. The Fairview System offers a broad continuum of health care services through its hospitals, clinics, ambulatory care centers, senior and long-term care facilities, retail and specialty pharmacies, pharmacy benefit management (“PBM”) services, rehabilitation centers, counseling and home health care programs, physician network and health insurance products. Fairview is a Minnesota non-profit corporation and is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code (the “IRC”).

On June 1, 2017, Fairview became the sole member of HealthEast Care System, a St. Paul, Minnesota non-profit corporation (“HealthEast”) that is exempt from federal income taxation under Section 501(c)(3) of the IRC, which together with its subsidiaries and affiliates operates a diversified health care system (collectively, the “HealthEast System”). The HealthEast System provides a continuum of health services including short-term acute-care and long-term acute care hospitals, primary and specialty care, hospice, home care and medical transportation.

The Fairview System and the HealthEast System (collectively, the “System”) serve the entire Metro Area, as well as communities throughout greater Minnesota and the upper Midwest and is one of the most comprehensive and geographically accessible systems in Minnesota. The System owns and operates eleven hospitals, including the University of Minnesota Medical Center, Fairview, a part of which is the University of Minnesota Masonic Children’s Hospital (collectively, “UMMC”), which is the adult and pediatric teaching hospital of the University of Minnesota (the “University”). UMMC and eight of the System’s other hospitals, including a long-term acute care hospital, are located in the Twin Cities of Saint Paul and Minneapolis, Minnesota Metro Area (“Metro Area”). The System’s other two hospitals are located in northern Minnesota. Together, the System also operates over 100 primary and specialty care clinics, six ambulatory care centers, over 40 retail and specialty pharmacies, as well as senior care housing and long-term care facilities, hospice and home care, medical transportation and a health plan.

The System has a goal to combine the best of both organizations to create a world-class health system committed to serving the communities and the region. The Fairview System and the HealthEast System provide care in complementary service areas with very little geographic overlap. The HealthEast System serves the eastern section area of the Metro Area and the Fairview System serves the south, west, central and north sections of the Metro Area as well as northern Minnesota. The System, through its integrated health care model, aims to deliver the benefits of academic medicine to more patients and families across the Metro Area by expanding care, research and education through access to a greater pool of physicians and patients, while reducing the total cost of care for patients. The System is led by Fairview Chief Executive Officer, James Hereford, and governed by the existing Fairview Board of Directors with the addition of three former HealthEast System board members.

Based on the third quarter of 2017 inpatient discharge statistics compiled by the Minnesota Hospital Association, the System is the second largest health care delivery system in the Metro Area with a combined 28.7% market share.

## HEALTH CARE SERVICES

In addition to the services detailed in the following sections, the System also offers urgent care, diagnostic laboratory services, and medical imaging services.

### HOSPITALS

The System owns and operates the following hospitals: (i) UMMC, (ii) Fairview Southdale Hospital, (iii) Fairview Ridges Hospital, (iv) Fairview Lakes Medical Center, (v) Fairview Northland Medical Center, (vi) Fairview Range Medical Center, (vii) Grand Itasca Clinic and Hospital, (viii) HealthEast St. Joseph's Hospital, (ix) HealthEast St. John's Hospital, (x) HealthEast Woodwinds Hospital and (xi) Bethesda Long Term Acute Care Hospital (collectively the "System Hospitals"). As of December 31, 2017, the System Hospitals had a total of 3,519 licensed beds and 2,140 staffed beds.

Fairview also holds a twenty-five percent membership interest in Maple Grove Hospital Corporation ("MGHC"), which operates a 130-bed community hospital in Maple Grove, Minnesota. North Memorial Health Care ("NMHC") holds the remaining seventy five percent membership interest in MGHC. Fairview guarantees twenty-five percent or about \$29.8 million of the debt service payable with respect to a series of tax exempt bonds with an aggregate principal amount outstanding of \$119.4 million as of December 31, 2017 for the benefit of MGHC. The guaranty terminates if MGHC achieves a stand-alone credit rating equal to the rating of "Baa1" or better from Moody's Investors Service.

### CLINICS, AMBULATORY CARE, PHARMACY AND OTHER SERVICES

**Clinic Services.** The System operates more than 100 primary and specialty care clinics throughout the Metro Area and greater Minnesota. These clinics offer services in over 70 medical specialties, including family medicine, pediatrics, obstetrics, gynecology, heart care, cancer care, otolaryngology, pre- and post-transplant care, and orthopedics.

**Ambulatory Surgery Centers.** The System owns all or a portion of six ambulatory surgery centers located in the Metro Area and northern Minnesota, described below:

- Fairview owns and operates Fairview Maple Grove Surgery Center, an ambulatory surgery center located in Maple Grove, Minnesota that provides multi-specialty adult and pediatric outpatient surgical care, including colonoscopy, otolaryngology, eye, gastroenterology, obstetrics and gynecology, orthopedics, plastic and reconstructive surgery, podiatry, endoscopy, urology and vascular services.
- Fairview is a 50% owner of Crosstown Surgery Center LLC, an ambulatory surgery center located in Edina, Minnesota that specializes in orthopedic surgery through the use of advanced technology.
- Fairview is a 51% owner of Ridges Surgery Center LLC, an ambulatory surgery center located in Burnsville, Minnesota that provides multi-specialty outpatient surgical care, including gynecology, orthopedics, podiatry, otolaryngology, ophthalmology, spine, anesthesia and general surgery services.
- Range Regional Health Services, of which Fairview is the sole member, is a 51% owner of Northwoods Surgery Center LLC, an ambulatory surgery center located in Virginia,

Minnesota that provides multi-specialty outpatient surgical care, including ophthalmology, orthopedics, otolaryngology and general surgery services.

- Fairview, through a joint venture with UMPHysicians, has a 50% membership interest in the University of Minnesota Health Clinics and Surgery Center (the “M Health CSC joint venture”) that provides outpatient clinic and surgical care for thirty-seven medical specialties including primary care, neurology, cardiology, dermatology, orthopedics, hepatology, solid organ transplant, ear, nose and throat, endoscopy, urology and vascular services. The M Health CSC joint venture outpatient specialty care and surgical services leases space within the new University of Minnesota Clinics and Surgery Center facility (“CSC”), which opened in February of 2016. Fairview also operates provider based clinics within the CSC.
- HealthEast is a 51.1% owner of HealthEast Surgery Center – Maplewood, LLC (with Surgical Care Associated (“SCA”) and independent physician partners owning the rest) which is a Minnesota limited liability company that owns a freestanding surgery center located in Maplewood, Minnesota (the “Maplewood Surgery Center”). The Maplewood Surgery Center is managed by SCA.

**Pharmacy Services.** As of December 31, 2017, Fairview, itself and through Fairview Pharmacy Services (“FPS”), owned and operated pharmacies at more than 40 locations, including a network of retail pharmacies, oncology pharmacies, a home infusion pharmacy, a remote dispensing pharmacy and a specialty pharmacy. The specialty pharmacy provides drugs and a variety of clinical management services for specialty diseases and chronic conditions including: cancer, cystic fibrosis, fertility treatment, growth hormone deficiency, hemophilia, hepatitis C, HIV, inflammatory conditions (Crohn’s disease, psoriasis, psoriatic arthritis, and rheumatoid arthritis), multiple sclerosis, pulmonary hypertension, metabolic disorders, and respiratory syncytial virus. The specialty pharmacy is affiliated with both the University Transplant Center and University Hemophilia Center, and separately provides home infusion therapy services. In addition to operating retail and specialty pharmacies, Fairview also provides mail order pharmacy, respiratory therapy, pharmaceutical care, pharmacy benefits management, retail merchandising, clinical trial services, medication therapy management, prison pharmacy, long term care pharmacy services, and physician office drug and supply services.

**Fairview Rehabilitation Services.** Fairview’s Rehabilitation Services (“FRS”) provides a range of inpatient and outpatient rehabilitation services for pediatric and adult patients: including an inpatient rehabilitation facility, a hospital based skilled nursing facility and an adult day program. Rehab services are provided in NICUs at four hospitals in addition to providing inpatient services at ten hospitals, FRS has a wide range of both hospital and clinic based outpatient sites providing cardiac rehab, cancer rehab, concussion rehab, neuro rehab, vestibular and audiology. Fairview also provides rehabilitation services through the Institute for Athletic Medicine (“IAM”), as well as Fairview’s seven orthotics and prosthetics clinics and seven hand centers. A joint venture between Fairview (which owns 63%) and North Memorial Health, IAM provides outpatient physical therapy, hand therapy, and chiropractic services for the treatment of a range of musculoskeletal and orthopedic conditions, including sports related injuries. Additionally, IAM provides athletic training services to twenty-eight high schools throughout the Metro Area. There are 28 clinic facilities operating under the IAM name, making IAM one of the largest providers of sports medicine services in the Upper Midwest. IAM is also a minority partner in two clinics that operate as a joint venture under the OSI brand, a therapist-owned physical therapy practice.

**HealthEast Medical Transportation.** HealthEast Medical Transportation (“HEMT”) offers emergency medical services for a changing, technology-driven world. HEMT provides emergency and scheduled transportation across the Metro Area and supports the community by providing more than 30,000 calls annually. Additionally, HEMT offers emergency vehicle services that specializes in the build and modifications required for vehicles used in public service for local, state and federal agencies.

## SENIOR HOUSING, LONG TERM CARE FACILITIES AND SENIOR SERVICES

The System provides a wide range of senior care facilities and services through Ebenezer, a non-profit subsidiary of Fairview. Ebenezer provides long-term senior care facilities, senior housing, adult day services, home care and hospice and rehabilitation services. Ebenezer’s goal is to provide a supportive environment where older adults can be rehabilitated so that they can achieve their highest level of independence.

Through Ebenezer, the System owns and operates four long-term senior care facilities in the Metro Area. Ebenezer also operates over 70 senior housing facilities (10 of which are owned and managed) in the Metro Area and greater Minnesota.

In addition to Ebenezer, the HealthEast System has a non-consolidated minority ownership interest of 45% in Cerenity Care Center, which provides senior living care facilities and services in the Metro Area.

## HEALTH PLAN SERVICES

PreferredOne is a health services organization, founded in 1984, that provides a comprehensive range of health benefit services, including insurance products and third party administrative (“TPA”) services, to employers and individuals throughout Minnesota and the upper Midwest, in addition to a national network for employers with employees throughout the United States. These services are provided through PreferredOne’s three companies – PreferredOne Community Health Plan, PreferredOne Administrative Services and its wholly owned subsidiary, PreferredOne Insurance Company (“PIC”). Collectively, the PreferredOne companies serve approximately 325,000 members, of which approximately 50,000 are fully insured at-risk members. The remaining membership composition includes approximately 90,000 network rental members and 185,000 in TPA employer sponsored self-funded plans. PIC also provides stop loss insurance policies for approximately 92,000 of the 185,000 TPA members. PreferredOne’s capital exceeds its regulatory requirements and 2017 growth.

## PHYSICIAN NETWORK

**Employed and Staffed Physicians,** The System has a large physician network which includes both employed and affiliated physicians. As of December 31, 2017, Fairview employed approximately 1,246 physicians. Approximately 672 of these physicians practice in the Fairview System’s clinics with the remaining physicians practicing at the System Hospitals in various medical specialties. HealthEast employed 335 physicians with an additional 500 affiliated physicians on staff, each as of December 31, 2017. Approximately 135 of these HealthEast employed physicians practice within primary care clinics.

**Fairview Physician Associates Network.** Fairview Physician Associates Network (“FPA”), a Minnesota nonprofit tax-exempt corporation of which Fairview is the sole corporate member, was incorporated in 1993. FPA is an integrated practice network of 3,407 providers, of which 2,445 are physicians, including the majority of Fairview employed physicians. As a physician led non-profit organization, FPA works to advance community health by improving the quality, patient experience and total cost of care of services delivered to patients. FPA, as a large, multi-specialty group, contracts with health plans. By helping its providers reach quality goals, FPA manages clinical risk for patient populations to enhance excellence of care. FPA also offers services to support clinical care, patient safety and to enhance clinical integration. In conjunction with Fairview, the FPA network provides a full range of primary care and specialty services.

**University of Minnesota Physicians.** In 1997, Fairview entered into an affiliation agreement (the “UMPhysicians Agreement”) with UMPPhysicians, a group practice of approximately 1,100 physicians, including over 900 University of Minnesota Medical School faculty members, who primarily practice within UMMC and other Fairview facilities and the University of Minnesota. UMPPhysicians is a non-profit organization that operates the direct patient care clinic practice of the University of Minnesota Medical School. The UMPPhysicians Agreement provides that the principal site for clinical practice for UMPPhysicians will be UMMC and the clinics located at UMMC. In addition, UMPPhysicians has agreed to use UMMC as the principal venue for educational and new research opportunities when and where appropriate resources are available at UMMC. Fairview has agreed to support UMMC as the flagship teaching hospital in accordance with the Affiliation Agreement.

Fairview and UMPPhysicians have also entered into a management services agreement pursuant to which UMPPhysicians agrees to manage Fairview’s outpatient specialty clinics located at UMMC and the Maple Grove Ambulatory Care Center. Fairview and UMPPhysicians have additional professional service agreements for medical directorships, hospitalist services, laboratory and pathology services, perfusion services, information services and cardiovascular service management. In 2013, Fairview and UMPPhysicians entered into an agreement (the “M Health Agreement”) to form University of Minnesota Health (“M Health”), a virtual integration of services provided by UMMC and UMPPhysicians to bring innovative, high quality health care to more people throughout Minnesota. This partnership adds to the existing long-term affiliation agreement with the University of Minnesota and UMPPhysicians and represents a closer integration of the organizations and their commitment to deliver the best care to patients in the way that best suits the patient’s individual need. The M Health Agreement provides for variable financial support based on the financial performance of M Health. M Health also participates with Fairview in making capital funding decisions at UMMC.

M Health integrates many operations of UMMC and UMPPhysicians, providing patients with streamlined access to a wide spectrum of specialists across all the facilities and services within M Health. The integration includes UMMC, integrated clinical service lines (such as heart care and cancer care), and specialty clinics within Fairview Maple Grove Ambulatory Care Center.

With the M Health Agreement expiring on June 30, 2018, Fairview, the University and UMPPhysicians are discussing the opportunity to simplify, clarify and improve the partnership between the organizations. The organizations are negotiating the next evolution of the partnership while the original affiliation agreement entered into in 1997 remains in place.

**Fairview Partners.** Fairview Partners is an integrated health care network, providing medical care for nursing home residents and other seniors through risk sharing insurance products. As of December 31, 2017, Fairview Partners had 2,661 members enrolled in three different health plans, including 1,602 members with UCare, 999 members with Medica, and 60 members with

Blue Cross Blue Shield. Fairview Partners currently serves both nursing home residents and seniors living in their own homes under the Minnesota Senior Health Options project. There are 28 community nursing homes (including two Ebenezer owned facilities) in the Metro Area participating in Fairview Partners.

## STRATEGIC ALLIANCES

**Fairview Health Network.** The System is committed to delivering on the Triple Aim goals of improving the patient experience, improving the health of populations and reducing the cost of healthcare. In order to accomplish this objective, Fairview has entered into various agreements with payers to manage quality, risk and cost across the full continuum of reimbursement models. For total cost of care contracts, Fairview uses a hybrid payment model that incorporates at risk elements based on quality, patient satisfaction and management of the total cost of care of a population, with health plan members attributed to the primary care clinics within Fairview based on utilization. These products create a mechanism in which Fairview is rewarded for reductions in total cost of care and improved quality through enhanced relationships with patients served. In 2016, Fairview's average cost of care was below the Metro Area average for its commercial contracts.

Fairview has also entered into limited network products with select health plans. In these products, the members enroll in a product which has lower premiums or member costs, but carry a significant out of pocket penalty for out of network utilization. Because the members are enrolled, the provider network is able to identify each member upon enrollment and as a result, can proactively design plans of care. In these limited network products, Fairview shares both in the margin and loss of the product.

In 2013 Fairview established a clinically integrated network comprised of Fairview, North Memorial and HealthEast, named the Relevant Network ("Relevant"). The goal of Relevant is to share best practices, improve outcomes, enhance patient satisfaction and advance total cost of care savings by establishing product offerings that are differentiated in the market. Relevant's member organizations align under an accountable care model and share governance responsibilities.

Fairview also has a long history of entering into at risk contracts for its government populations, including a risk sharing contract between FPA and UCare for seniors. Fairview participated in the Medicare Pioneer Accountable Care Organization ("Pioneer") program. In 2017, Fairview and FPA entered into the Next Generation Accountable Care Organization ("Next Generation") program for the Medicare population, which is the replacement for the Pioneer program. The rules and methodology for the program are similar to Pioneer and as a result of participation in this Alternative Payment Methodology with Medicare, Fairview and FPA's primary care providers will be exempt from the Medicare Incentive Payment System (MIPS) and the risk of decreased payment rates associated with the MIPS system.

Through preliminary reporting in the Next Gen program, it appears that the medical costs associated with Fairview's attributed population in this program greatly exceed the targeted cost for the population. Because of this variance, Fairview projects a payment required to CMS of roughly \$6 million. This variance is driven largely because of the cap on risk adjustment in the program for 2017. The acuity of the population increased by over 8% but was capped at a 3% increase. If the acuity adjustment had not been capped there would have been no loss in the program. The Next Generation ACO Model is designed to improve clinical quality and patient experience, while reducing the total cost of care for Medicare beneficiaries. We have determined

that the model design penalizes ACOs that already deliver high quality and low-cost care. As a result, we cannot be successful in the current model design and will discontinue our participation and has elected to exit the Next Gen program for 2018.

In 2017, Fairview and FPA entered into the State's Medicaid Integrated Health Partnership program ("MIHP"). This program is similar to Next Generation, but is focused on Fairview attributed members of the State's Medicaid and Medicaid Managed Care programs. Early indication is that Fairview will beat the target and earn a small shared savings payment.

As noted above, HealthEast participated in several risk based products with Fairview through the Relevant Health Network products. Also, HealthEast joined with other independent physician groups to create Community Health Network (CHN). Starting in 2013, CHN joined the Medicare shared savings program. In 2017, CHN also enrolled in the state's MIHP program.

In total, these agreements have established quality outcomes and/or shared savings incentives or limited risk contracts with commercial and governmental payers that now cover over 460,000 lives. With the proliferation of both public and private insurance exchanges, a continued increase in this financial model is anticipated and Fairview is well positioned to take advantage of that market shift.

**ExceleraRx.** Fairview, along with several other health systems from across the United States, formed the Excelera Specialty Pharmacy Network, a national network of specialty pharmacies owned by integrated delivery systems and academic medical centers. This network brings together like minded health systems and academic medical centers to work together around specialty drugs and caring for complex and chronic patients. ExceleraRx Corp ("Excelera") was formed as a vehicle to facilitate and support the network. As of December 31, 2017, the network consisted of 20 integrated delivery systems and academic medical centers.

The Excelera network provides members nationally scaled infrastructure, technology and support to develop best practices for specialty pharmacy capabilities and gain access to limited distribution drugs and biologics and restrictive payer agreements, which allows members to provide continuity of care for patients with complex and chronic conditions, leading to improved health outcomes and decreased healthcare costs. Members pay Excelera fees in exchange for such services. This integrated coordinated care model is intended to drive higher quality while reducing the total cost of care.

Excelera's current owners are FPS, Catholic Health Initiatives of Englewood, Colorado; Intermountain Healthcare of Salt Lake City, Utah; Banner Health of Phoenix, Arizona; Henry Ford Health System of Detroit, Michigan; Avera McKenna of Sioux Falls, South Dakota; and Regional Health of Rapid City, South Dakota.

**Other Strategic Alliances.** The System has a number of other strategic alliances in place with other health care providers and payers and is periodically engaged in discussions with both existing partners about the expansion of current relationships and various other parties regarding possible new alliances. These alliances are expanded or established to provide more comprehensive patient care and services. Future alliances could take the form of affiliations, partnerships, joint ventures, acquisitions, mergers or other arrangements.

## INFORMATION TECHNOLOGY

The System's Hospitals and clinics are utilizing the Epic electronic health record system. The Epic system assists care givers in providing care to all patients at the System Hospital and clinic care locations by improving patient safety, enhancing care coordination between medical professionals and ensuring the timeliness and accuracy of the revenue cycle processes.

The Health Information Technology for Economic and Clinical Health Act, established by the American Recovery and Reinvestment Act of 2009, provides for Medicare and Medicaid incentives payable to eligible organizations and providers that adopt and meaningfully use certified electronic health record technology. As of December 31, 2017, the System's Hospitals and employed providers attested that they met the criteria under years one and two for stage one and year one and two for stage two of CMS's meaningful use programs. The System recognized \$2.0 million, \$3.0 million, and \$7.6 million in other operating revenue under these programs for the fiscal years ended 2017, 2016 and 2015, respectively.

Fairview has also invested in virtual care throughout the entire Fairview System—from hospitals, emergency departments and clinics to home care and hospice, pharmacy, senior living community and home-based settings. Many virtual care initiatives expand access in rural communities to specialty care, providing video appointments and consultations with a wide range of specialists in areas such as maternal-fetal medicine, cardiology, psychiatry, infectious disease and dermatology. Fairview's tele-ICU offers remote monitoring by intensivists and registered nurses certified in critical care. Fairview offers remote behavioral health crisis assessments in six emergency departments, as well as remote interpreter services capabilities. Video consultation with Medication Therapy Management pharmacists brings their expertise to a variety of clinic, assisted living and home-based settings. Fairview also has several programs to monitor patient health status in their homes. In addition, Fairview's partnership with Zipnosis, through its OnCare brand, provides online diagnosis and treatment for patients with select conditions that generally do not require a trip to the doctor. The System also offers convenient remote diagnosis and treatment capabilities via Epic's MyChart (patient portal) for many conditions that do not require a clinic office visit. Additionally, the System has developed advanced video-visit capabilities within Epic to support expanded virtual care offerings.

## RECENT ACQUISITIONS, EXPANSION PROJECTS, AND OTHER UPDATES

**Senior Services Expansion.** Ebenezer has entered into contracts to manage several new senior living communities currently being constructed by various third-party developers. A highlighted selection of the managed developments is described below:

- Stonehaven Senior Living, located in Eagan, Minnesota, will include 75 independent/assisted living, 15 memory care apartments, in addition to guest suites and entertainment facilities. The development will open in August 2018.
- Crest Ridge Senior Living, located in Minnetonka, Minnesota, will include 127 independent/assisted living, 20 memory care apartments, in addition to guest suites and entertainment facilities. The development will open in the summer of 2019.

- Pillars of Mankato Senior Living, located in Mankato, Minnesota, will include 84 independent/assisted living, 21 memory care apartments, in addition to guest suites and entertainment facilities. The development will open in the spring of 2019.
- Mission Hills Senior Living in Chanhassen, Minnesota is a senior living campus that will include 134 apartments for assisted and independent living, along with 18 units in nine villa-like buildings, and a closed, 14 suite memory care wing. The facility is expected to open in the summer of 2019, and will feature a commercial kitchen, theater, salon, dining area, clinic, fitness area and chapel.

**HealthEast Ambulatory Surgery Care Joint Venture.** On May 1, 2017, HealthEast entered into an agreement with Summit Orthopedics Ltd. to take a minority non-controlling joint venture interest (20.0%) in the Vadnais Heights Surgery Center ("VHSC"). VHSC is focused exclusively on providing orthopedic surgical care. This transaction is expected to close in Q2 2018.

**Grand Itasca Clinic and Hospital-Cancer Center.** In response to expected growth in demand for cancer care services in the Grand Rapids service area due to the aging population, Grand Itasca Hospital renovated and expanded its clinical space for specialty services, including an approximately 6,500 square-foot space dedicated to its growing oncology program. The renovation added 10 private, semi-private, and shared infusion bays, a private entrance for patient safety and windows to the outdoors to create a peaceful environment. The expansion project also creates pharmacy capacity for chemotherapy medication. The Cancer Center opened in February 2018.

**Rating Agencies Update.** In August 2017, Moody's Investors Service affirmed Fairview's outstanding revenue bonds at an A2 bond rating with a stable outlook.

In July 2017, Standard & Poor's affirmed Fairview's outstanding revenue bonds at an A+ bond rating with a stable rating.

**Debt Refunding.** In late August 2017, the System closed on the issuance of \$202.1 million of tax-exempt Series 2017A bonds to refund existing HealthEast and Grand Itasca debt. At the same time, Fairview also entered taxable term loans of \$190.8 million with two banks to refund existing HealthEast taxable direct placement debt. The System successfully issued the new debt at lower interest rates than the original debt acquired. These issuances resulted in a \$9.5 million loss on early extinguishment of debt, but the System is expected to experience annual interest cost savings on this debt going forward.

Concurrent with the issuance of the Series 2017A tax-exempt Bonds and 2017 taxable term loans, HealthEast, HealthEast St. Joseph's Hospital, HealthEast St. John's Hospital, HealthEast Woodwinds Hospital and Grand Itasca Clinic and Hospital joined Fairview's obligated group.

## AWARDS AND RECOGNITION.

**Centers for Medicare and Medicaid Services – Hospital Ratings.** Six Fairview hospitals received four stars or higher in overall hospital quality from the Centers for Medicare & Medicaid Services (CMS). CMS evaluates more than 4,000 hospitals nationwide and assigns them one to five stars, with five being the best possible rating. Designed to help patients compare hospitals, the CMS rating system is based on 57 publicly reported quality measures across performance areas, such as patient experience, safety of care, readmission and effectiveness of care. The overall rating summarizes up to 57 quality measures reflecting common conditions that hospitals treat, such as heart attacks or pneumonia. The overall rating shows how well each hospital performed, on average, compared to other hospitals in the U.S.

Fairview's top-rated hospitals are:

- Fairview Southdale Hospital (Edina): 5 stars
- Fairview Ridges Hospital (Burnsville): 4 stars
- Fairview Northland Medical Center (Princeton): 4 stars
- Fairview Lakes Medical Center (Wyoming): 4 stars
- Grand Itasca Clinic & Hospital (Grand Rapids): 4 stars
- Woodwinds Health Campus (Woodbury): 4 stars

Fairview Southdale was one of only eight hospitals in Minnesota—and 337 nationwide—to receive a five-star rating.

**U.S News & World Report – Best Hospitals.** U.S. News & World Report recognized six of our hospitals for providing world-class patient care and named two to its 2017-18 “Best Hospitals” list. Each year, U.S. News & World Report evaluates more than 4,500 hospitals across the nation, assessing objective measures such as survival and readmission rates, volume, patient experience, patient safety and quality of nursing, among other care-related indicators.

Hospitals are ranked nationally in 25 adult care specialties—from cancer to urology—and rated in common procedures and conditions such as heart bypass surgery, hip and knee replacement and colon cancer surgery. The rankings are the result of the System's shared commitment to better clinical outcomes, clinical research and a multi-disciplinary approach to cancer care is improving care for our patients every day.

### Our rankings:

#### **Fairview Ridges Hospital**

High-performing rating in knee replacement

#### **Fairview Southdale Hospital**

- Named a 2017-18 Best Regional Hospital
- High-performing rating in abdominal aortic aneurysm repair, colon cancer surgery, heart failure, hip replacement, knee replacement and lung cancer surgery
- Top 5 Best Hospitals in Minneapolis-St. Paul
- Top 10 Best Hospitals in Minnesota

#### **St. John's Hospital**

- High-performing rating in colon cancer surgery

#### **St. Joseph's Hospital**

- High-performing rating in heart failure

#### **University of Minnesota Medical Center**

- High-performance rating in seven specialties: Gastroenterology and GI surgery, geriatrics, nephrology, neurology and neurosurgery, orthopedics, pulmonology, urology
- High-performing rating in four procedures: heart failure, hip replacement, knee replacement and lung cancer surgery
- Top 5 Best Hospitals in Minneapolis-St. Paul
- Top 5 Best Hospitals in Minnesota
- Top 50 nationally in cancer care

#### **Woodwinds Health Campus**

- High-performing rating in hip replacement and knee replacement

**Healthcare Purchasing News – Supply Chain.** Healthcare Purchasing News (HPN), a health care business news magazine, has named Fairview supply chain the 2017 Supply Chain Department of the Year. The award recognizes the department's collaboration, innovation and "center of excellence" approach to managing all aspects of supply chain activities.

#### **American Heart Association certifications:**

**Heart Failure-** University of Minnesota Medical Center, Fairview Southdale Hospital, Fairview Ridges Hospital, St. Joseph's Hospital, St. John's Hospital, and Woodwinds Hospital each received "gold" certification, while Fairview Northland Medical Center and Fairview Range Medical Center both received "silver" status.

**Stroke-** Fairview Southdale Hospital received "silver" certification status. To achieve the award, a hospital must be dedicated to developing, assessing and delivering evidence-based treatments and consistent adherence to the latest scientific treatment guidelines for heart failure care.

To achieve both awards, a hospital must be dedicated to developing, assessing and delivering evidence-based treatments and consistent adherence to the latest scientific treatment guidelines for heart failure care.

**Practice Greenhealth – Partner for Change Award.** Fairview Ridges Hospital, Fairview Southdale Hospital, and University of Minnesota Medical Center East and West Banks - Recognizes superior performance in environmental sustainability at the hospital level.

**Healthgrades – Distinguished Hospital Award for Clinic Excellence.** Fairview Ridges Hospital, Fairview Southdale Hospital, and HealthEast St. John's Hospital were recognized for hospitals rated in the top 5% in the nation with the lowest risk-adjusted mortality and complication rates across at least 21 of 32 common conditions and procedures.

**Women's Choice Awards.** Five Fairview hospitals have been honored with 2018 Women's Choice Awards® recognizing the country's best health care organizations based on women's perspectives on patient satisfaction, clinical excellence and hospital preferences.

2018 Women's Choice Awards went to:

- Fairview Southdale Hospital for bariatric surgery, cancer care and heart care.
- St. John's Hospital for cancer care and patient safety.
- St. Joseph's Hospital for bariatric surgery, heart care and patient safety.
- University of Minnesota Medical Center for bariatric surgery, cancer care and stroke care.
- Woodwinds Health Campus for obstetrics and stroke care

**Becker's Hospital Review- 110 Accountable Care Organizations to Know.** Fairview Health Services was named to the 2017 edition of Becker's Hospital Review's "100 Accountable Care Organizations (ACOs) to Know" for the fifth year in a row. The list recognizes organizations from across the country based on their excellence in quality, achievements in driving down cost and ability to grow and take on risk. Fairview has been named to this list every year since 2012, when it was first published by Becker's Hospital Review. Fairview is one of only three ACOs in Minnesota to be named to the list this year.

#### OBLIGATED GROUP AND OTHER FAIRVIEW SUBSIDIARIES

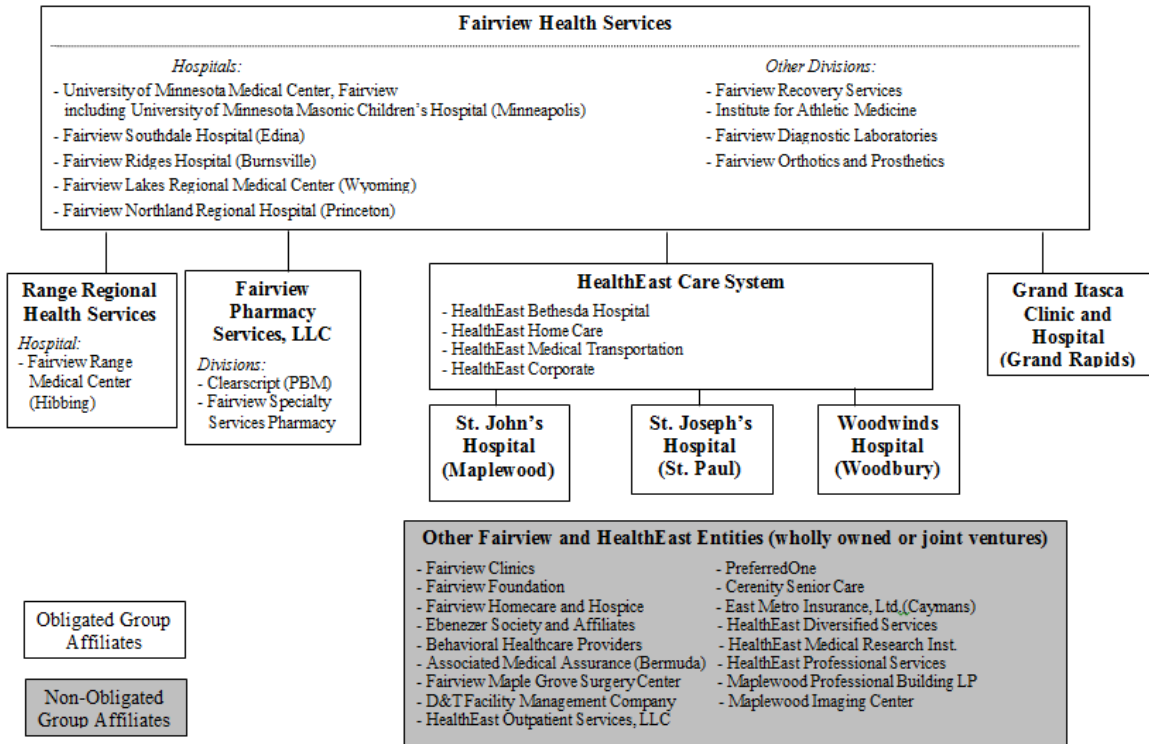
Fairview Health Services, Range Regional Health Services and Fairview Pharmacy Services, LLC (collectively, "Obligated Affiliates") are members of an Obligated Group under a master trust indenture dated September 1, 2015, as supplemented and amended. The master trust was amended in August 2017 to include HealthEast Care System, HealthEast, St. Joseph's Hospital, HealthEast St. John's Hospital, HealthEast Woodwinds Hospital and Grand Itasca Clinic and Hospital. The master trust indenture states that the Obligated Affiliates are jointly and severally liable for certain debt obligations and subject to certain covenants.

The Obligated Group accounted for approximately 87% of Fairview's consolidated total operating revenue for the nine months ended December 31, 2017, and approximately 90% of Fairview's total consolidated assets at December 31, 2017.

None of the other Fairview subsidiaries, joint ventures, or partnerships in which Fairview has an interest are members of the Obligated Group (collectively these excluded entities are referred to as the "Non-Obligated Group").

The following exhibit illustrates the significant entities comprising the System and indicates whether each entity is a member of the Obligated Group.

# **FAIRVIEW AND FAIRVIEW SUBSIDIARIES**



## GOVERNANCE AND MANAGEMENT

**Executive Management.** The names, titles, ages and professional backgrounds of the executive officers of Fairview are set forth below.

*James Hereford (58), Fairview President and Chief Executive Officer.* Mr. Hereford was appointed President and Chief Executive Officer on October 27, 2016 with an effective date of December 12, 2016. Mr. Hereford joined Fairview after serving as Chief Operations Officer at Stanford Health Care from 2013 to 2016 where he was responsible for all inpatient and ambulatory operations as well as various administrative functions. Prior to his role at Stanford, he was Chief Operations Officer at the Palo Alto Medical Foundation where he was responsible for operations serving more than 800,000 people in the San Francisco Bay area. Mr. Hereford holds bachelor's and master's degrees in mathematics from Montana State University. He has taught courses with Stanford University's Graduate School of Business, University of Washington's Master of Health Administration program and The Ohio State University's masters of Business Operations Excellence Program.

*M. Osman Akhtar (42), Chief Operating Officer.* Mr. Akhtar was named Chief Operating Officer in July 2017. Prior to joining Fairview, Mr. Akhtar was the Bay Area vice president of operational integration for Sutter Health from 2015 to 2017. He also was Chief Administrative Officer of the Palo Alto Foundation Medical Group from 2010 to 2014 and Vice President for clinical services and strategic development for the Palo Alto Medical Foundation from 2014 to 2015, an affiliate of Sutter Health. Before joining Sutter Health, Mr. Akhtar worked at two academic medical centers: Stanford University School of Medicine and Washington University's School of Medicine. He holds a master's degree in health administration and a Bachelor of Arts degree in psychology, both from St. Louis University.

*Bob Beacher (62), Chief of Shared Clinical Services.* Mr. Beacher has administrative responsibility for the System's laboratory, radiology, rehabilitation, and pharmacy teams. In addition, he serves as president of Fairview Pharmacy Services. Mr. Beacher is a registered pharmacist and earned his bachelor's degree from the University of Minnesota. Mr. Beacher, with more than 30 years of health care experience, is a member of several state and national pharmacy associations and serves on Fairview's Ethics Committee.

*Kathryn Correia (60), Chief Administrative Officer.* Mrs. Correia joined Fairview on June 1, 2017 as Chief Administrative Officer to lead Fairview's marketing, communications, customer and patient relations, community health, foundations and government relations efforts. Prior to her new role, Ms. Correia served as President and Chief Executive Officer of HealthEast from 2012 to 2017. Ms. Correia also previously served as president of Appleton Medical Center (from 2003 to 2011) and Senior Vice President of ThedaCare Physician Group (from 1993 to 2002). Prior to joining ThedaCare, she was Vice President for ambulatory care centers and Administrative Director for clinic operations at Geisinger Health System in Danville, Pennsylvania. Ms. Correia received her bachelor's degree from Denison University in Granville, Ohio, and her master's degree in Health Administration from The Ohio State University. Ms. Correia will be leaving Fairview with her last day being May 4. A transition plan for Ms. Correia's areas of accountability, which include marketing and communications, customer and patient relations, community health, foundations and government relations, will be developed over the next few weeks.

*Daniel Fromm (52), Senior Vice President and Chief Financial Officer.* Mr. Fromm leads the effort to shape Fairview's financial performance, with responsibility for revenue cycle, treasury, financial planning, accounting, tax, government reimbursement, pricing, real estate, data and

health informatics, acquisitions and product development and operations finance. In addition to his financial responsibilities, he is responsible for managing purchaser and payer relationships, as well as negotiation of managed care contracts. Mr. Fromm was Fairview's vice president of finance prior to being named to his current role in 2011. Prior to joining Fairview in 2000, he was controller at Children's Hospital and Clinics of Minnesota and held various financial management positions at the former University of Minnesota Hospital and Clinics (now UMMC). Mr. Fromm is a certified public accountant (inactive), holds a bachelor's degree in business administration from Bethel University, and has attained Six Sigma Green Belt certification.

*Carolyn Jacobson (56), Chief Human Resources Officer.* Ms. Jacobson is responsible for all aspects of human resources, including talent recruitment and performance management, compensation and benefits, employee and labor relations, training and development and human resources administration. Ms. Jacobson joined Fairview in 2008 from Honeywell where she was global organizational effectiveness leader. She has worked in organizational development and leadership training for more than 20 years and earned a bachelor's degree from the University of Minnesota.

*Alistair Jacques (56), Senior Vice President and Chief Information Officer.* Mr. Jacques oversees the management of electronic health record, business and other information systems. Mr. Jacques joined Fairview in 2014 with more than 30 years of information technology experience in the United States and the United Kingdom. Prior to joining Fairview, he held a variety of information technology leadership roles at UnitedHealth Group, where he worked for more than 10 years. Before that, he was with Cargill, Northwest Airlines, Ernst & Young, Shearson Lehman and Barclays Bank. Mr. Jacques holds an undergraduate degree in business studies from Manchester University, England.

*Laura Reed, RN, DNP (56), Chief Nursing Executive.* Ms. Reed rejoined Fairview in July 2017 as Chief Nursing Executive. Prior to her new role, Ms. Reed was with ThedaCare where she served as their Chief Nurse Executive from 2015 to 2016 and as their Chief Operating Officer from 2016 to 2017. Previously Ms. Reed held several leadership positions including Chief Nurse Executive for the University of Minnesota Health (from 2013 to 2015). She also had a prior position of Senior Vice President patient care services and Chief Nursing Officer for Mercy Medical Center in Cedar Rapids, Iowa from 2011 to 2013. She holds an executive master's degree in business administration and a master's degree in nursing from the University of Iowa. She received her bachelor's degree in nursing from Coe College and a diploma in nursing from the Finley Hospital School of Nursing.

*Trudi Noel Trysla (51), Chief Legal Officer and General Counsel.* Ms. Trysla develops Fairview's overall legal strategy, leads Fairview's legal and ethical adherence to federal and state law and health care public policy, and oversees the Fairview's legal and risk management functions. Ms. Trysla was named general counsel in February 2014 and has more than 20 years of legal experience in health care. She joined Fairview in 2008 as associate general counsel. Prior to joining Fairview, Ms. Trysla served as senior legal counsel at Medtronic, Inc.; as legal counsel for Mayo Foundation in Rochester, Minnesota; and as an attorney in private practice. Ms. Trysla earned her law degree from the University of Minnesota and her bachelor's degree from the University of Nebraska.

*Mark Welton, MD (61), Chief Medical Officer.* Mr. Welton became Chief Medical Officer of Fairview in July 2017. Prior to joining Fairview, Mr. Welton was the Harry A. Oberhelman Jr. Professor of Surgery and Chief of Colon and Rectal Surgery in the Stanford University School of Medicine and Chief of Staff for Stanford Hospital and Clinics from 2007 to 2017. He is board certified in general surgery and colon and rectal surgery. He serves on the American Board of

Surgery, the American Board of Colon and Rectal Surgeons and the American Society of Colon and Rectal Surgeons Research Foundation. He received his MD and completed his surgical residency at University of California, Los Angeles before completing a fellowship in Colon and Rectal Surgery at Washington University.

*Genevieve Melton-Meaux, MD, PhD (46) Chief Data & Health Informatics Officer.* Genevieve joined University of Minnesota Physicians in 2008 as a colon and rectal surgeon and currently has over a twelve years of experience as an informatics researcher, data scientist, and informatics leader. She holds undergraduate degrees in mathematics, electrical engineering, and computer science. Genevieve earned her medical degree followed by surgical residency at Johns Hopkins University. She also completed a postdoctoral fellowship in biomedical informatics at Columbia University, a PhD in Health Informatics at University of Minnesota, and clinical fellowship in colon and rectal surgery at the Cleveland Clinic.

*Beth Thomas, DO (56) Chief Quality & Patient Safety Officer.* Beth earned her medical degree from the Chicago College of Osteopathic Medicine and completed her residency at New Britain General Hospital, University of Connecticut. She serves on the board of Grand Itasca Clinic & Hospital.

**BOARD OF DIRECTORS.** The Board of Directors of Fairview (the “Board”) governs Fairview and HealthEast and is responsible for, among other matters, the assets of the System, quality, patient care, compliance and its overall business and financial performance. The System’s bylaws authorize up to 21 directors: nine elected directors, not less than three and not more than nine appointed directors and three ex-officio directors. The three ex officio directors are the President and CEO of Fairview, the Dean of the University of Minnesota Medical School and the Vice President for Health Sciences or the actual or acting chief executive of health sciences colleges of the University of Minnesota Medical School or of the University of Minnesota (“University”). The remaining members of the Board include elected and at large members as determined by the Board as well as communities, service areas and populations served by Fairview subsidiaries or related organizations or divisions, both of which categories of members are elected by the Board, with one of the directors elected by the Regents of the University. The President and CEO of the System is the only System employee who may serve on the Board.

**CORPORATE GOVERNANCE POLICIES.** The Board is committed to sound and effective corporate governance practices. The Governance Committee regularly reviews and adopts “best practices” in corporate governance and recommends changes to Fairview’s corporate governance policies or processes as appropriate.

Fairview has a conflict-of-interest policy that applies to all members of the Board and requires disclosure of any conflict of interest or potential conflict of interest and includes a process for review and decision making relative to such disclosures.

## **Section Two – Year-to-Date Financial Statements**

Fairview Health Services  
Consolidated Balance Sheets  
(Dollars in Thousands)  
(Unaudited)

	December 31, 2017	December 31, 2016
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 51,503	\$ 37,300
Short-term investments	616,727	491,663
Accounts receivable for medical services, less allowance for doubtful accounts of \$71,626 in 2017 and \$50,870 in 2016	583,239	439,378
Receivable under third-party payor contracts	4,002	2,233
Current portion of contributions receivable	9,032	12,304
Inventories	102,996	104,482
Other current assets	148,551	101,061
Total current assets	1,516,050	1,188,421
Investments	1,709,040	1,356,524
Assets limited as to use:		
Held by insurance subsidiaries	68,622	49,672
Restricted fund investments	35,570	24,878
Other assets limited as to use	3,059	1,915
Total assets limited as to use	107,251	76,465
Other long-term assets:		
Contributions receivable	11,771	15,495
Investments in related parties	84,722	77,819
Goodwill and intangible assets	80,553	70,655
Other long-term assets	63,523	26,026
Total other long-term assets	240,569	189,995
Land, buildings and equipment, net	1,383,402	1,000,946
Total assets	\$ 4,956,312	\$ 3,812,351

See accompanying notes.

Fairview Health Services

Consolidated Balance Sheets (continued)

(Dollars in Thousands)

(Unaudited)

	December 31, 2017	December 31, 2016
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 299,364	\$ 275,498
Accrued compensation and benefits	348,542	258,468
Payable under third-party payor contracts	10,849	16,836
Current maturities of long-term debt	23,692	17,948
Other current liabilities	131,406	76,834
Total current liabilities	813,853	645,584
Other liabilities:		
Captive insurance subsidiaries claims reserves	49,070	25,845
Workers' compensation claims reserves	43,812	32,229
Derivative financial instruments	67,086	68,781
Other long-term liabilities	77,173	46,778
Total other liabilities	237,141	173,633
Long-term debt	1,387,402	986,679
Total liabilities	2,438,396	1,805,896
Net assets:		
Unrestricted:		
Fairview Health Services	2,412,555	1,947,967
Noncontrolling interests	50,843	12,290
Total unrestricted	2,463,398	1,960,257
Temporarily restricted	54,518	46,198
Total net assets	2,517,916	2,006,455
Total liabilities and net assets	\$ 4,956,312	\$ 3,812,351

See accompanying notes.

Fairview Health Services

Consolidated Statements of Operations and Changes in Net Assets  
(Dollars in Thousands)  
(Unaudited)

	Year Ended December 31,		Three Months Ended December 31,	
	2017	2016	2017	2016
Unrestricted revenues:				
Net patient service revenue	\$ 4,704,084	\$ 3,857,555	\$ 1,345,232	\$ 1,012,720
Provision for bad debts	(82,738)	(54,003)	(26,004)	(16,729)
Net patient service revenue less provision for bad debts	4,621,346	3,803,552	1,319,228	995,991
Other operating revenue	650,578	552,930	163,169	147,066
Net assets released from restrictions	3,093	7,058	1,253	660
Total unrestricted revenues	5,275,017	4,363,540	1,483,650	1,143,717
Expenses:				
Salaries and benefits	2,483,099	1,938,283	693,512	495,495
Supplies	1,389,256	1,197,782	383,764	320,777
Purchased services	740,583	635,317	195,052	172,203
Utilities and maintenance	151,249	119,481	45,470	34,537
Insurance and rent	81,072	65,452	26,702	18,901
State and local taxes	85,830	79,634	25,907	16,810
Other operating expenses	58,824	41,087	17,856	9,616
Depreciation and amortization	135,174	116,156	33,819	29,793
Interest	51,456	39,711	13,859	10,265
Total expenses	5,176,543	4,232,903	1,435,941	1,108,397
Operating income	98,474	130,637	47,709	35,320
Nonoperating gains (losses):				
Investment return	198,797	78,728	48,829	2,248
(Losses) gains on interest and basis rate swaps, net	(5,545)	(3,231)	(236)	34,319
Contribution (decrease) from business combinations	174,948	15,950	(3,460)	(1,805)
Other nonoperating (losses), net	(9,752)	(882)	(526)	(413)
Total nonoperating gains	358,448	90,565	44,607	34,349
Excess of revenues over expenses	456,922	221,202	92,316	69,669
Less amounts attributable to noncontrolling interests	(4,994)	(7,416)	(2,359)	(3,115)
Excess of revenues over expenses attributable to Fairview Health Services	\$ 451,928	\$ 213,786	\$ 89,957	\$ 66,554

See accompanying notes.

Fairview Health Services

Consolidated Statements of Operations and Changes in Net Assets (continued)  
(Dollars in Thousands)  
(Unaudited)

	Year Ended December 31,		Three Months Ended December 31,	
	2017	2016	2017	2016
Unrestricted net assets, Fairview Health Services				
Excess of revenues over expenses	\$ 451,928	\$ 213,786	\$ 89,957	\$ 66,554
Pension and other post-retirement liability adjustments	1,413	(1,763)	1,413	(1,763)
Contributions for long-lived assets and other changes	11,247	9,452	(4,271)	6,547
Increase in unrestricted net assets, Fairview Health Services	464,588	221,475	87,099	71,338
Unrestricted net assets, noncontrolling interests:				
Excess of revenues over expenses	4,994	7,416	2,359	3,115
Contributions from noncontrolling interests	10	6,149	-	411
Contributions from business combinations	43,987	-	(3,000)	-
Distributions to noncontrolling interests and other changes	(10,438)	(9,681)	(1,195)	(1,861)
Increase (decrease) in unrestricted net assets, noncontrolling interests	38,553	3,884	(1,836)	1,665
Temporarily restricted net assets:				
Contributions and other changes, net	10,223	14,982	4,233	5,555
Contributions from business combinations	12,650	-	223	-
Net assets released from restrictions	(14,553)	(12,154)	(3,547)	(5,756)
Increase (decrease) in temporarily restricted net assets	8,320	2,828	909	(201)
Total increase in net assets	511,461	228,187	86,172	72,802
Net assets at beginning of period	2,006,455	1,778,268	2,431,744	1,933,653
Net assets at end of period	\$ 2,517,916	\$ 2,006,455	\$ 2,517,916	\$ 2,006,455

See accompanying notes.

Fairview Health Services  
Consolidated Statements of Cash Flows  
(Dollars in Thousands)  
(Unaudited)

	Year Ended December 31,	
	2017	2016
<b>Operating activities</b>		
Increase in net assets	\$ 511,461	\$ 228,187
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	135,174	116,156
Provision for bad debts	82,738	54,003
Pension and other post-retirement liability adjustments	(1,413)	1,763
Net realized and unrealized gains on trading investments	(168,478)	(52,363)
Change in fair value of interest and basis rate swaps, net	(1,618)	(4,378)
Loss on early extinguishment of debt	9,397	—
Contributions from business combinations	(239,861)	(15,951)
Other, net	(2,704)	(10,706)
Changes in assets and liabilities:		
Accounts receivable for medical services	(89,899)	(87,656)
Other current assets	(8,257)	(41,178)
Current liabilities	23,323	41,482
Other assets and liabilities, net	(9,509)	(18,972)
Net cash provided by operating activities before changes in trading investments	240,354	210,387
Change in trading investments	(137,038)	(183,424)
Net cash provided by operating activities	103,316	26,963
<b>Investing activities</b>		
Purchases of land, buildings and equipment, net	(94,687)	(77,462)
Business acquisitions	7,363	31,168
Other investing activities	—	—
Net cash used in investing activities	(87,324)	(46,294)
<b>Financing activities</b>		
Issuance of long-term debt	460,809	1,605
Principal payments on long-term debt	(19,140)	(19,463)
Early extinguishment of long-term debt	(450,177)	—
Collateral received (posted) on derivative financial instruments	—	35,550
Other financing activities, net	6,719	7,513
Net cash (used in) provided by financing activities	(1,789)	25,205
Increase in cash and cash equivalents	14,203	5,874
Cash and cash equivalents at beginning of period	37,300	31,426
Cash and cash equivalents at end of period	\$ 51,503	\$ 37,300
<b>Supplemental disclosure of noncash investing and financing activities</b>		
Assets acquired through capital leases	\$ —	\$ 44,256
Accruals for purchases of buildings and equipment	\$ 6,997	\$ 3,323

See accompanying notes.

Fairview Health Services  
Consolidating Balance Sheets  
December 31, 2017  
(Dollars in Thousands)  
(Unaudited)

	Obligated Group	Non- Obligated Group	Eliminations and Reclasses	Consolidated Totals
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 19,877	\$ 31,626	\$ -	\$ 51,503
Short-term investments	573,373	43,354	-	616,727
Accounts receivable for medical services, less allowance for doubtful accounts	544,832	39,123	(716)	583,239
Receivable under third-party payor contracts	4,002	-	-	4,002
Current portion of contributions receivable	8,033	999	-	9,032
Inventories	100,815	2,181	-	102,996
Other current assets	115,200	44,228	(10,877)	148,551
Total current assets	1,366,132	161,511	(11,593)	1,516,050
Investments	1,642,240	66,800	-	1,709,040
Assets limited as to use:				
Held by insurance subsidiaries	-	68,622	-	68,622
Restricted fund investments	12,840	22,730	-	35,570
Other assets limited as to use	28	3,031	-	3,059
Total assets limited as to use	12,868	94,383	-	107,251
Other long-term assets:				
Contributions receivable	11,468	303	-	11,771
Investments in related parties	84,370	1,310	(958)	84,722
Goodwill and intangible assets	45,476	35,077	-	80,553
Other long-term assets	82,654	4,620	(23,751)	63,523
Total other long-term assets	223,968	41,310	(24,709)	240,569
Land, buildings and equipment, net	1,239,099	144,303	-	1,383,402
Total assets	\$ 4,484,307	\$ 508,307	\$ (36,302)	\$ 4,956,312

See accompanying notes.

Fairview Health Services

Consolidating Balance Sheets (continued)

December 31, 2017

(Dollars in Thousands)

(Unaudited)

	Obligated Group	Non- Obligated Group	Eliminations and Reclasses	Consolidated Totals
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 288,057	\$ 15,623	\$ (4,316)	\$ 299,364
Accrued compensation and benefits	304,544	43,998	-	348,542
Payable under third-party payor contracts	10,696	153	-	10,849
Current maturities of long-term debt	21,181	2,511	-	23,692
Other current liabilities	77,755	60,630	(6,979)	131,406
Total current liabilities	702,233	122,915	(11,295)	813,853
Other liabilities:				
Insurance subsidiaries claims reserves	27,369	21,701	-	49,070
Workers' compensation claims reserves	43,732	80	-	43,812
Derivative financial instruments	67,086	-	-	67,086
Other long-term liabilities	65,679	39,406	(27,912)	77,173
Total other liabilities	203,866	61,187	(27,912)	237,141
Long-term debt	1,321,081	66,321	-	1,387,402
Total liabilities	2,227,180	250,423	(39,207)	2,438,396
Net assets:				
Unrestricted:				
Fairview Health Services	2,181,578	228,072	2,905	2,412,555
Noncontrolling interests	42,560	8,283	-	50,843
Total unrestricted	2,224,138	236,355	2,905	2,463,398
Temporarily restricted	32,989	21,529	-	54,518
Total net assets	2,257,127	257,884	2,905	2,517,916
Total liabilities and net assets	\$ 4,484,307	\$ 508,307	\$ (36,302)	\$ 4,956,312

See accompanying notes.

Fairview Health Services

Statement of Operations and Changes in Net Assets  
Year Ended December 31, 2017  
(Dollars in Thousands)  
(Unaudited)

	Obligated Group	Non- Obligated Group	Eliminations and Reclasses	Consolidated Totals
Unrestricted revenues:				
Net patient service revenue	\$ 4,351,530	\$ 392,318	\$ (39,764)	\$ 4,704,084
Provision for bad debts	(75,710)	(7,028)	-	(82,738)
Net patient service revenue less provision for bad debts	4,275,820	385,290	(39,764)	4,621,346
Other operating revenue	302,929	436,677	(89,028)	650,578
Net assets released from restrictions	2,856	3,222	(2,985)	3,093
Total unrestricted revenues	4,581,605	825,189	(131,777)	5,275,017
Expenses:				
Salaries and benefits	2,069,648	425,024	(11,573)	2,483,099
Supplies	1,370,798	39,917	(21,459)	1,389,256
Purchased services	503,410	286,359	(49,186)	740,583
Utilities and maintenance	141,124	10,125	-	151,249
Insurance and rent	57,949	36,394	(13,271)	81,072
State and local taxes	71,439	14,391	-	85,830
Other operating expenses	56,573	38,539	(36,288)	58,824
Depreciation and amortization	123,218	11,956	-	135,174
Interest	47,261	4,195	-	51,456
Total expenses	4,441,420	866,900	(131,777)	5,176,543
Operating income (loss)	140,185	(41,711)	-	98,474
Nonoperating gains (losses):				
Investment return	190,604	8,193	-	198,797
(Losses) on interest and basis rate swaps, net	(5,545)	-	-	(5,545)
Gains on business acquisitions	174,948	-	-	174,948
Other nonoperating (losses), net	(9,663)	(89)	-	(9,752)
Total nonoperating gains	350,344	8,104	-	358,448
Excess (deficit) of revenues over expenses	490,529	(33,607)	-	456,922
Less amounts attributable to noncontrolling interests	(3,305)	(1,689)	-	(4,994)
Excess (deficit) of revenues over expenses attributable to Fairview Health Services	\$ 487,224	\$ (35,296)	\$ -	\$ 451,928

See accompanying notes.

Fairview Health Services

Statement of Operations and Changes in Net Assets (continued)

Year Ended December 31, 2017

(Dollars in Thousands)

(Unaudited)

	<b>Obligated Group</b>	<b>Non- Obligated Group</b>	<b>Eliminations and Reclasses</b>	<b>Consolidated Totals</b>
Unrestricted net assets, Fairview Health Services:				
Excess (deficit) of revenues over expenses	\$ 487,224	\$ (35,296)	\$ -	\$ 451,928
Capital contribution	(103,124)	100,219	2,905	-
Contribution from business acquisitions	7,742	-	-	7,742
Pension and post-retirement liability adjustments	1,413	-	-	1,413
Contributions for long-lived assets and other changes	10,090	(6,585)	-	3,505
Increase in unrestricted net assets, Fairview Health Services	403,345	58,338	2,905	464,588
Unrestricted net assets, noncontrolling interests:				
Excess of revenues over expenses	3,305	1,689	-	4,994
Contributions from noncontrolling interests	-	10	-	10
Contributions from business combinations	41,986	2,001	-	43,987
Distributions to noncontrolling interests and other changes	(3,150)	(7,288)	-	(10,438)
Increase in unrestricted net assets, noncontrolling interests	42,141	(3,588)	-	38,553
Temporarily restricted net assets:				
Contributions and other changes, net	4,638	5,585	-	10,223
Contributions from business combinations	12,211	439	-	12,650
Net assets released from restrictions	(10,184)	(4,369)	-	(14,553)
Increase in temporarily restricted net assets	6,665	1,655	-	8,320
Total increase in net assets	452,151	56,405	2,905	511,461
Net assets at beginning of period	1,804,976	201,479	-	2,006,455
Net assets at end of period	<u>\$ 2,257,127</u>	<u>\$ 257,884</u>	<u>\$ 2,905</u>	<u>\$ 2,517,916</u>

See accompanying notes.

## **Fairview Health Services**

### **Notes to Consolidated Financial Statements (Unaudited)**

*(Dollars in Thousands)*

#### **1. Organization and Basis of Presentation**

Fairview Health Services, an integrated health system, along with its affiliates and subsidiaries is a non-profit corporation headquartered in Minnesota and is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code (the "IRC"). Fairview offers a broad continuum of health care services through its hospitals, clinics, senior and long-term care facilities, retail and specialty pharmacies, pharmacy benefit management ("PBM") services, rehabilitation centers, counseling and home health care programs, physician network and health insurance products.

The consolidated financial statements include the accounts of the System, which includes both tax-exempt and taxable entities. All significant inter-affiliate and inter-company balances and transactions have been eliminated in consolidation.

The System has prepared the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Although the consolidated financial statements are unaudited, the System believes all normal and recurring adjustments considered necessary for the fair presentation of our financial position and operating results have been included.

The information included in this quarterly disclosure should be read in conjunction with the most recent audited consolidated financial statements and accompanying notes for the year ended December 31, 2016. Other than those noted, there have been no additional subsequent events requiring recognition or disclosure or supplemental disclosures that have occurred since the date of the audited consolidated financial statements.

### **Section Three – Key Performance Indicators**

	Twelve Months Ended December 31, 2017 <sup>1</sup>	2016 <sup>2</sup>
<u>Hospitals and Surgery Centers</u>		
Medical/Surgical staffed beds	2,026	1,505
Long-term acute care staffed beds	<u>114</u>	<u>-</u>
Total Staffed beds	2,140	1,505
Medical/surgical inpatient admissions	79,057	58,661
Long-term acute care inpatient admissions	568	-
Behavioral inpatient admissions	10,894	8,584
Skilled nursing inpatient admissions	<u>415</u>	<u>364</u>
Total Inpatient admissions	90,934	67,609
Outpatient registrations <sup>3</sup>	1,009,780	848,075
Emergency room visits	282,323	207,227
Observation days	21,940	17,380
Deliveries	12,292	9,209
Inpatient surgeries	27,881	22,976
Hospital outpatient surgeries	42,616	37,155
Ambulatory care centers surgeries	<u>11,784</u>	<u>17,314</u>
Total Surgeries	82,281	77,445
Medical/surgical patient days	358,850	293,221
Long-term acute care patient days	16,267	-
Behavioral patient days	89,391	68,451
Skilled nursing patient days	<u>6,135</u>	<u>4,867</u>
Total Patient Days	470,643	366,539

<sup>1</sup> Certain 2017 Key Performance Indicators include twelve-month data for Grand Itasca Clinic & Hospital and seven months of data for HealthEast which were acquired in 2017.

<sup>2</sup> HealthEast and Grand Itasca Clinic and Hospital acquired in 2017 therefore not included in 2016 data

<sup>3</sup> Outpatient registrations do not include activity transferred from UMMC to the M Health CSC joint venture upon its opening in late February 2016

	Twelve Months Ended December 31,	
	2017 <sup>4</sup>	2016
Occupancy %	60.3%	66.2%
Case mix index	1.63	1.60
Medical/surgical average length of stay	4.5	5.0
Long-term acute care length of stay	28.6	-
Behavioral average length of stay	8.2	8.0
Skilled Nursing length of stay	<u>14.8</u>	<u>13.4</u>
Total Average Length of Stay	5.2	5.4
<u>Clinics and Other Ambulatory Care</u>		
Clinic work RVUs	4,243,169	2,936,892
Clinic visits	1,333,285	1,323,005
Institute for Athletic Medicine visits	204,767	211,341
Home Care visits	929,081	426,661
Orthotics & Prosthetics procedures	10,655	10,287
<u>Long-Term Senior Care Facilities</u>		
Beds in service	522	581
Skilled nursing patient days	177,059	170,331
Skilled nursing admissions	2,262	1,855
Occupancy %	92.9%	87.2%
<u>Other Statistics</u>		
Total provider FTEs	1,527	902
Pharmacy unit sales	2,336,017	2,303,314
<u>Health Plan Services</u>		
Membership	327,532	250,282

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<sup>4</sup> Certain 2017 Key Performance Indicators include results from Grand Itasca Clinic & Hospital and HealthEast which were acquired in 2017. 2016 data does not include Grand Itasca Clinic & Hospital and HealthEast.

	Twelve Months Ended December 31,	
	2017	2016
<b>Profitability Ratios:</b>		
EBIDA Margin	5.4%	6.6%
Operating Margin	1.9%	3.0%
Total Margin	8.7%	5.1%
	December 31, 2017	December 31, 2016
<b>Liquidity Ratios:</b>		
Days Cash on Hand	159.2	167.6
Days Cash on Hand (Obligated Group)	175.4	181.2
Debt Service Coverage Ratio (Ob. Group)	4.9	5.2
Days in Accounts Receivable – Hospitals	51.4	51.9
Days in Accounts Receivable – Clinics	34.2	35.0
Cash to Debt	168.5%	187.7%
<b>Capital Structure Ratios:</b>		
Debt to Capitalization	36.4%	33.9%

## **Section Four – Management’s Discussion and Analysis of Financial Condition and Results of Operations**

## **Management's Discussion and Analysis of Financial Condition and Results of Operations for the Twelve Months Ended December 31, 2017**

The purpose of this section is to provide a narrative explanation of the System's financial statements, thereby providing readers a more comprehensive understanding of the organization. In turn, this will enhance overall financial disclosure, provide a more informed context within which the System's financial information may be analyzed and highlight information about the quality and potential variability of our financial condition, results of operations and cash flows.

### **Quarter-to-Date Financial Results**

For the three months ended December 31, 2017, the System's total operating revenue of \$1,483.7 million grew by \$339.9 million or 29.7% over the comparable period in 2016, while net patient service revenue increased by \$323.2 million or 32.5% primarily due to the acquisitions of the HealthEast System, which contributed \$191.9 million of total operating revenue, and Grand Itasca Clinic and Hospital ("Grand Itasca"), which contributed \$11.8 million of total operating revenue, both of which became affiliates during 2017.

Net operating income for the quarter was \$47.7 million, compared to \$35.3 million in the same quarter of 2016 driving an operating margin of 3.2% for the fourth quarter 2017 compared to a net operating margin of 3.1% in the same quarter 2016. The increase in net operating income was largely attributable to the performance drivers below.

- NOI generated from 2017 acquisitions of HealthEast and Grand Itasca in Q4 driven by the combination of higher volumes in the quarter, favorable contractual adjustments and bad debt write-offs, as a percent of revenue, compared to that reported by Fairview in the same quarter in the prior year
- Higher pharmacy revenue compared to the same period in the prior year driven by increased specialty volumes and PBM activity
- The above activity partially offset by continued operating losses related to ramp-up of the M Health Clinics and Surgery Center joint venture

Combined with results of operations, the System's consolidated excess of revenues over expenses was \$93.9 million compared to revenues over expenses of \$66.9 million in the same period from 2016.

The increase from the prior year was due to the higher flow through of net operating income combined with increased investment income of \$48.8 million, which exceeded the \$2.2 million reported in the same quarter last year.

### **Year-to-Date Financial Results**

For the year ended December 31, 2017, the System's total operating revenue of \$5,275.0 million grew by \$911.5 million or 20.9% over the comparable period in 2016, while net patient service revenue increased by \$817.8 million or 21.5%. Key drivers of the revenue growth included:

- Higher total operating revenue from acquisitions of the HealthEast System on June 1, 2017, which contributed \$575.2 million in revenue, and Grand Itasca on January 1, 2017, which contributed \$88.5 million in revenue
- Hospital volume growth within general medicine, behavioral, outpatient oncology, cardiac, and lab patient care areas
- Higher hospital inpatient acuity, driving increased per unit pricing and reimbursement
- Increased pharmacy services revenue driven by specialty prescription and increased PBM revenue from pharmacy membership growth
- Increased premium revenue from PreferredOne membership growth
- As a partial offset, decreased reimbursement due to a less-favorable payer mix compared to the prior year, brought about by the combination of a greater percentage of reimbursement from government programs and higher levels of patient-liable activity driven by individuals/families choosing to forgo coverage due to increased premium cost and growth in high-deductible insurance plan products within the market

Net operating income for the year was \$98.5 million, compared to \$130.6 million in the same period of 2016 driving net operating margin of 1.9% for 2017 compared to a net operating margin of 3.1% in 2016. Earnings before interest, depreciation and amortization margin was 5.4% compared to 6.6% in the previous year. The decrease in net operating income was largely attributable to the items noted above offset by:

- Increased salaries and benefits due to inflationary and employment market pressures
- Higher supplies expense from both a percent of revenue and total dollars perspective, due to increased supply usage associated with higher patient and pharmacy volumes in addition to unit cost increases outstripping reimbursement
- Higher medical claims expense which is tied directly to higher-than-planned membership growth
- Operating losses from the M Health CSC due to longer time to ramp volumes, lower overall outpatient volumes as they were diverted to the new CSC, and higher discounts as a percent of revenue
- Certain one-time strategic planning and transaction costs associated with recent acquisitions and related integration efforts

Combined with results of operations, the System's consolidated excess of revenues over expenses was \$456.9 million compared to \$221.2 million in the same period from 2016.

The increase from the prior year was due to gains on acquisitions, higher investment performance as the investment portfolio generated returns of \$198.8 million, compared to a \$78.7 million return through the same period in 2016 partially offset by the higher losses on interest rate swaps of \$5.5 million compared to a \$3.2 million loss in the prior year and the flow-through of lower NOI from above.

Further discussion of contributing factors follows below.

#### *Total Operating Revenues*

Total operating revenue of \$5,275.0 million includes inpatient and outpatient hospital revenues, clinic patient revenue, pharmacy services, and other aspects of our diverse care continuum, as well as non-patient revenues including, PBM fees, rental income, management fees, health plan

member premiums, joint venture earnings and income from cafeterias, transportation fees, gift shops and parking which are components of other operating revenue.

<i>\$ in millions</i>	<b>Year-to-date December 2017</b>	<b>Year-to-date December 2016</b>	<b>Variance</b>	<b>% Variance</b>
Net patient revenue	\$4,621.3	\$3,803.6	\$817.7	21.5%
Other operating revenue	\$653.7	\$560.0	\$93.7	16.7%
<b>Total operating revenue</b>	<b>\$5,275.0</b>	<b>\$4,363.6</b>	<b>\$911.4</b>	<b>20.9%</b>

#### *Net Patient Service Revenue*

Net patient service revenue was \$4,621.3 million, an increase of 21.5% over the comparable period in 2016. Patient services revenue is generated from a variety of sources that include managed care and indemnity-based health insurance companies, the federal Medicare program, as well as state Medicaid programs and uninsured patients (i.e. patients who do not have health insurance and are not covered by other forms of third-party arrangements). The composition of net patient service revenue was as follows:

	<b>Year-to-date December 2017</b>	<b>Year-to-date December 2016</b>	<b>Variance</b>	<b>% Variance</b>
Net inpatient revenue %	45.4%	45.6%	(0.2%)	(0.4%)
Net outpatient revenue %	54.6%	54.4%	0.2%	0.4%

The percentage of gross System patient charges by payment source was as follows:

	Year-to-date December 2017	Year-to-date December 2016	Variance	% Variance
Governmental:				
Medicare	35.0%	32.2%	2.8%	8.7%
Medicaid	19.2%	18.8%	0.4%	2.1%
Other	1.1%	1.2%	(0.1%)	(8.3%)
	55.4%	52.2%	3.2%	6.1%
Negotiated contracts and other:				
Blue Cross Blue Shield	13.3%	16.3%	(3.3%)	(20.2%)
Medica	9.5%	9.5%	0.0%	0.0%
HealthPartners	8.3%	7.9%	0.4%	5.1%
PreferredOne	4.8%	5.2%	(0.4%)	(7.7%)
Other	8.5%	11.6%	(3.1%)	(26.7%)
	44.0%	48.5%	(4.5%)	(9.3%)
Self-pay	1.2%	1.0%	0.2%	20.0%
Total	100.0%	100.0%	0.0%	0.0%

Through December 2017, the System experienced a higher proportion of gross patient revenue from Medicare, Medicaid, and self-pay patients compared to the prior year.

	Year-to-date December 2017	Year-to-date December 2016	Variance	% Variance
<b>Unit Pricing Metrics: <sup>(1)</sup></b>				
Net inpatient rev per admission	\$19,300	\$21,454	(\$2,154)	(10.0%)
Net inpatient rev per patient day	\$6,304	\$3,957	(\$2,347)	(59.3%)
Net outpatient rev per registration <sup>(2)</sup>	\$1,209	\$1,083	\$126	11.6%
Clinic net patient rev per wRVU <sup>(3)</sup>	\$155	\$156	(\$1)	0.6%
<b>Other Key Revenue Elements:</b>				
Prior period revenue (in millions)	\$12.8	\$2.9	\$9.9	341.4%
Quality/TCOC revenue (in millions)	\$13.6	\$12.0	\$1.6	13.3%

(1) Excludes quality incentives and total-cost-of-care ("TCOC") shared savings revenue and Grand Itasca.

(2) Excludes HealthEast

(3) Includes FMG, M Health Maple Grove, Urologic Physicians and Range Clinics

Unit pricing trends are mixed when compared to the prior year. Improvements were made across most operating units, reflecting revenue cycle enhancements through denial avoidance and improved documentation in addition to an overall trend toward higher acuity within our hospitals.

However, hospital patient days increased and the mix of patients in both hospitals and clinics has shifted toward government contracts tempering the favorability.

Net inpatient revenue per admission was \$19,300 which was 10.0% lower than the prior year and largely attributable to the change in payer mix and the addition of the HealthEast System hospitals with generally lower acuity levels relative to the Fairview System hospitals. Net outpatient revenue per registration was \$1,209, which is 11.6% higher than the prior year due to the mix of services performed including higher cardiac, drug, lab, imaging, and oncology volumes. Clinic net patient revenue per provider work RVU was \$155 which was comparable to the period of the prior year of \$156 as lower Medicaid rates through the Affordable Care Act were partially offset by favorable payer and service mix.

#### *Patient Activity*

The following table provides details on 2017 patient activity levels compared to the prior year:

	<b>Year-to-date December 2017</b>	<b>Year-to-date December 2016</b>	<b>Variance</b>	<b>% Variance</b>
Inpatient admissions	90,934	67,609	23,325	34.5%
Hospital patient days	470,643	366,539	104,104	28.4%
Average length of stay	5.2	5.4	(0.2)	(3.7%)
Outpatient registrations	1,009,780	848,075	161,705	19.1%
Total surgeries	82,281	77,445	4,836	6.2%
Observation days	21,940	17,380	4,560	26.2%
Emergency room registrations	282,323	207,227	75,096	36.2%
Hospital case mix index (1)	1.63	1.60	0.03	1.9%
Clinic wRVUs(1)	4,243,169	2,936,892	1,306,277	44.5%
(1) Excludes Grand Itasca				

Inpatient admissions were 34.5% higher compared to the same period last year due mainly to the addition of newly acquired HealthEast and Grand Itasca hospitals as well as increased patient demand across nearly all existing hospitals partially due to increased infectious disease cases. Inpatient service mix changes at Lakes and Northland hospitals contributed to higher patient acuity levels, reflected in a 1.9% increase in our overall hospital case mix index.

Outpatient registrations increased by 19.1% compared to the same period in 2016 due mainly to the newly acquired HealthEast System and Grand Itasca hospitals. The increased volume was partially offset by the transfer of cases from UMMC to the new M Health Clinics and Surgery Center joint venture relative to the prior period.

Physician clinic work RVUs increased 44.5% over 2016, due largely to the addition of the HealthEast System and Grand Itasca clinics and associated providers on June 1, 2017 and January 1, 2017 respectively. Through comprehensive initiatives such as membership in accountable care organizations, expansion of retail clinics, and innovative virtual care investments, the System continues to emphasize growth through care model innovation, increasing access to existing and new providers, and increasing patient awareness within the market.

Volumes within our non-hospital and physician clinic operating units were mixed year-over-year. Patient visits to the Institute for Athletic Medicine were 3.1% lower than the prior year due to

intense competitive pressures in the marketplace while orthotics and prosthetic procedures were up 3.6% from 2016 due to the resolution of physician transitions experienced in the prior year. Home care visits were 117.8% greater than the prior year due to the newly acquired HealthEast home care services, expanded services, increased patient demand and expanded coordination of care within the Fairview System hospitals and clinics. Pharmacy unit sales also increased 1.4% over the prior year, driven by demand and growth within specialty pharmaceuticals, including the continued availability of new medications, in addition to PBM membership growth within existing clients year over year. Finally, Ebenezer resident days were 1.6% lower when compared to the prior year due to differences in the anticipated timing of patient turnover and open beds reserved for patients awaiting county waivers.

### *Uncompensated Care*

Overall uncompensated care for 2017 totaled \$108.3 million which was \$36.4 million higher than 2016, as follows:

<i>\$ in millions</i>	<b>Year-to-date December 2017</b>	<b>Year-to-date December 2016</b>	<b>Variance</b>	<b>% Variance</b>
Charity care (at estimated cost)	\$25.6	\$17.9	\$7.7	43.0%
Bad debt	\$82.7	\$54.0	\$28.7	53.1%
<b>Total uncompensated care</b>	<b>\$108.3</b>	<b>\$71.9</b>	<b>\$36.4</b>	<b>50.6%</b>
<i>% of total operating revenue</i>	<i>2.1%</i>	<i>1.6%</i>	<i>0.5%</i>	<i>31.3%</i>

Bad debt was higher than the prior year due to the addition of Grand Itasca and HealthEast which accounted for \$3.0 million and \$12.4 million, respectively. In addition, the System experienced higher bad debt levels stemming from an increase in self-pay activity, as more individuals chose to forgo individual coverage due to higher premiums, growth in high-deductible insurance plans, and increased deductibles within insurance plans. Charity care has increased from the prior year due to increased patient need.

As noted above, a significant driver of bad debt is the level of patient liable receivables and that segment of accounts receivable was 19.9% of our total net accounts receivable at December 31, 2017, which is higher than the comparable period in the prior year due to market factors described previously. The System continues to enhance revenue cycle processes to improve collections and reduce exposure to bad debts. Collections are impacted by the economic ability of patients to pay and the effectiveness of our collection efforts. The System continues to focus on collection initiatives that promote coverage opportunities for our patients and enhance process efficiencies to reduce collection costs for these account categories. The System is dedicated to implementing best practices, enhancing the use of technology to improve the accuracy and timeliness of billing and payment processing, and investing in staff training throughout the revenue cycle to provide market-leading customer service. We believe that in doing so we will increase patient satisfaction, improve collections and reduce outstanding accounts receivable.

The average collection rate on hospital-based patient-liable accounts, excluding the HealthEast System and Grand Itasca, which is the blended collection rate for uninsured and self-pay after insurance accounts receivable, was approximately 63.6% for the year ended December 31, 2017 versus 67.0%, or a 2.4% decrease, compared to the full year 2016 due to increased bad debt referrals from the continued shift in patient liable activity.

Patient advocates from our financial counseling program assist patients to determine whether those patients meet eligibility requirements for various financial assistance programs, including charity care. They also expedite the process of applying for acceptance into certain government programs. Receivables from patients who are potentially eligible for Medicaid are classified as such, pending resolution of the associated application with appropriate estimated allowances recorded.

While both bad debt and charity care levels increased from 2016, they continue to be lower than historical trends as a percent of revenue, in part, due to the impact of the Affordable Care Act expanding Medicaid coverage to patients that were previously uninsured. Hospital charity care write-offs as a percent of gross patient revenue has declined from 0.42% in 2013 prior to the Act's inception, to 0.28% for the year ended December 31, 2017.

The process of estimating the allowance for doubtful accounts requires us to estimate the collectability of self-pay accounts receivable, which is primarily based on our collection history for that category of receivable, adjusted for expected recoveries and anticipated changes in collection trends. We continually review our overall reserve adequacy by monitoring historical cash collections as a percentage of trailing net revenue less provision for bad debts, as well as by analyzing current period net revenue and patient activity by payer classification, aged accounts receivable and various other factors.

#### *Other Operating Revenue*

Other operating revenue of \$653.7 million increased by \$93.7 million or 16.7% compared to the previous year. Key factors include:

- Higher revenue from acquisitions of the HealthEast System on June 1, 2017, which contributed \$12.4 million, and Grand Itasca on January 1, 2017, which contributed \$1.0 million in revenue
- Pharmacy benefit management revenue growth over the prior year, due to membership growth within existing clients year-over-year
- Increased insurance premium revenue within PreferredOne over the prior year due to increased membership in 2017
- Increased facility management fees related to Ebenezer as senior services managed services continues to grow

#### *Efficiency and Effectiveness of Operations*

A summary of key performance metrics is provided in the table below:

	Year-to-date December 2017	Year-to-date December 2016	Variance	% Variance
Salaries and benefits % TOR	47.1%	46.4%	0.7%	1.5%
Hospital FTE per 100 CMI-adj admissions <sup>(1)</sup>	5.36	5.52	(0.16)	(2.9%)
Total FTEs	25,959	18,868	7,091	37.6%
Salaries and benefits per adjusted patient day <sup>(1)</sup>	\$1,808	\$1,882	(\$74)	(3.9%)
Clinic staff to provider ratio <sup>(1)</sup>	3.21	3.16	0.05	1.6%
Purchased services (\$ in millions)	\$740.6	\$635.3	\$105.3	16.6%
Supplies % of TOR	26.3%	27.4%	(1.1%)	(4.0%)

(1) Excludes Range Hospital and Clinics, Grand Itasca and HealthEast

Salaries and benefits expense as a percentage of total operating revenue was 47.1%, which was 1.5% higher than the prior year ratio of 46.4% due to the addition of Grand Itasca Clinic and Hospital and the HealthEast System which have a higher salary and benefit cost structure in addition to expansion of legacy Fairview hospital and clinic services including new provider FTEs, a higher FTE count within Ebenezer associated with growth in managed senior care facilities, and increases in overtime staffing costs when compared to the prior year due to staffing coverage needs.

Hospital productivity levels were higher period over period as FTEs per Case Mix Index ("CMI") adjusted admissions were 2.9% lower than the prior year. Physician clinic staff-to-provider ratio was modestly higher at 3.21 compared to 3.16 for the same period last year due to staff FTEs added to support new providers and the commensurate practice ramp-up.

Supplies expense was 26.3% as a percentage of total operating revenue, which is lower than the prior year ratio of 27.4%. This was attributable to the combination of health plan revenue growth and the addition of Grand Itasca and HealthEast which have a lower proportion of revenue in supply intensive service lines.

Purchased services expense of \$740.6 million increased 16.6% compared to the same period in 2016. This is primarily driven by increased medical claims associated with increased health plan premium revenue for PreferredOne, increased PBM cost of sales associated with FPS revenue growth, and costs associated with recently acquired hospitals and clinics not in the prior year run rate.

Depreciation and amortization expense totaled \$135.2 million, which was higher than the prior year of \$116.2 million as capital spending was essentially flat year-over-year within the Fairview System with costs from recently acquired entities during 2017 driving the increased expense.

State and local taxes totaled \$85.8 million which was \$6.2 million higher than the prior year as a combination of additional provider taxes associated with the Grand Itasca and HealthEast acquisitions, provider care taxes associated with increased net patient service revenues over the same period, and income taxes associated with tax law changes within PreferredOne.

Utilities, maintenance, insurance and rent expenses were \$47.4 million higher than the same period in 2016 due primarily to \$41.5 million of costs from the acquisitions of Grand Itasca and HealthEast in 2017 in addition to increased number of software maintenance programs entered during 2017, and facilities expansion costs.

Year-to-date interest expense was \$51.5 million compared to the prior year total of \$39.7 million. The increase was due to the addition of the HealthEast System and Grand Itasca's debt combined with lower capitalized interest in the current year from lower capital spending. The System was able to reduce the cost of the acquired Grand Itasca and HealthEast System debt by refunding the debt at lower interest rates, with the refunded debt closing at the end of August. The year-to-date, all-in effective interest rate, including swap-related cash flows was 4.6% compared to last year's average year-to-date rate of 4.8% due to the addition of HealthEast debt.

## **Investment and Interest Rate Swap Results**

For the year ended December 31, 2017, total investment income was \$198.8 million, which was \$120.1 million favorable to last year. The System's long-term and short-term portfolios returned

13.9% and 1.0%, respectively. This investment activity does not include earnings on restricted investments, which are returned directly to temporarily and permanently-restricted funds.

<i>\$ in thousands</i>	<b>Year Ended December 2017 Cash Flow Income</b>	<b>Year Ended December 2017 Market Value</b>	<b>Net Swap Change</b>	<b>Mark to Market Valuation</b>
Variable basis swaps	(\$1,525)	\$2,533	\$1,008	-
Fixed payer swaps	(\$5,638)	(\$915)	(\$6,553)	(\$67,086)
<b>Total</b>	<b>(\$7,163)</b>	<b>\$1,618</b>	<b>(\$5,545)</b>	<b>(\$67,086)</b>

The total liability of swap contracts increased slightly to \$67.1 million through December 31, 2017 and have generated a total loss of \$5.5 million through December 31, 2017. Interest rate swaps had negative cash flows of \$7.2 million and non-cash, mark-to-market gains of \$1.6 million caused by a flattening of the yield curve since year-end 2016. Although the fixed payer swaps generated negative cash flows, they are structured to synthetically fix the 2008 CDE bond interest expense to minimize interest expense volatility. The total notional value of outstanding swaps is \$222.5 million, which is \$125.0 million lower from December 31, 2016 balance due to the termination of Fairview's variable basis swaps in 2017. The System did not have any collateral posted against the swap liability at year-end.

### **Balance Sheet and Cash Flow**

The Fairview System acquired Grand Itasca on January 1, 2017 and the HealthEast System on June 1, 2017 which in total increased net assets on the Fairview System's consolidated balance sheet by \$239.9 million.

<i>\$ in millions</i>	<b>Year Ended December 2017</b>	<b>Year Ended December 2016</b>	<b>Variance</b>
Total Unrestricted Liquidity Reserves	\$2,377.3	\$1,885.5	\$491.8
Average Daily Operating Expense	\$14.9	\$11.2	\$3.7
Days Cash on Hand	159.2	167.6	(8.4)
Total Debt Outstanding	\$1,411.1	\$1,004.6	\$406.5
Unrestricted Net Assets	\$2,464.4	\$1,960.3	\$504.1
Cash to Debt Ratio	168.5%	187.7%	(19.2%)
Debt to Capitalization Ratio	36.4%	33.7%	2.7%

## Days Cash on Hand Roll-Forward

	<b>Cash and Investments</b>	<b>Days Cash On Hand</b>
<b>Beginning Cash and Investments - December 31, 2016</b>	<b>\$ 1,885.5</b>	<b>167.6</b>
Earnings before interest, depreciation, and amortization	285.1	19.1
Growth in operating costs per day	-	(41.3)
Investment & swap activity	198.8	13.3
Capital expenditures	(101.4)	(6.8)
Debt activity, net	(52.4)	(3.4)
Cash acquired in business acquisition, net	190.5	12.8
Working capital and other changes	(28.8)	(2.1)
<b>Ending Cash and Investments - December 31, 2017</b>	<b>\$ 2,377.3</b>	<b>159.2</b>

Primary drivers of the change in working capital include timing of payments for accounts payable, and an increase in self-pay patient accounts receivable days and the additional working capital included in the acquisition of Grand Itasca and the HealthEast System.

Net patient accounts receivable totaled \$583.3 million at December 31, 2017, an increase of \$143.9 million from December 31, 2016. Corresponding patient accounts receivable days outstanding were 45.6 at December 31, 2017 compared to 45.4 days at December 31, 2016. Other current assets have grown approximately \$29.5 million from December 31, 2016 as the amounts owed to the System by the M Health CSC joint venture (for services provided by the System to the joint venture) have grown over the last year.

Accounts payable totaled \$269.3 million at December 31, 2017, an increase of \$26.4 million due to due to the addition of Grand Itasca and HealthEast. Accrued salaries and benefits totaled \$348.5 million at December 31, 2017, an increase of \$90.1 million due to the addition of Grand Itasca and HealthEast and the timing of pay periods in December 2017.

The increase in operating costs per day is due to general cost inflation and business growth in addition to the effect of acquiring Grand Itasca and the HealthEast System which drove 32.8 days of the 41.3 days growth in operating costs per day when comparing to year-end 2016. The higher operating costs relative to the overall system associated with pharmacy revenue, most notably from specialty pharmacy drugs, lowered days cash on hand by 3.1 days. Lastly, PreferredOne operating costs have increased year over year due to higher fully insured membership. Without Pharmacy and PreferredOne expenses, days cash on hand would increase from the current 159.2 to 208.6. It is important to note that while both PreferredOne and Pharmacy have a dilutive impact on days cash on hand levels due to the associated operating costs, the costs are variable expenses that are covered by revenue.

## Capital and Joint Venture Investments

Capital expenditures funded through December 31, 2017 total \$101.4 million. The Fairview System analyzes and manages capital needs under a formal review process for the authorization of capital expenditures. The System expects to continue to invest in information systems, modern technologies and the reconfiguration of facilities to more effectively provide patient care services, and to provide for a greater variety of clinical services consistent with demand throughout the communities we serve.

Investments in related parties totaled \$85.7 million at December 31, 2017 which increased from the December 2016 balance of \$77.8 million due to the favorable performance from certain investments and the addition of the Grand Itasca and HealthEast System joint ventures.

### **Reserves and Debt**

The System maintains reserves for self-insured liabilities, including workers' compensation, professional and general liability and employee health insurance. The System continually monitors these reserves, including projected activity and market dynamics, to ensure proper recognition of liabilities and expense throughout the year. The total amount of reserves related to self-insured activity recorded as of December 31, 2017 was \$137.0 million, which is \$50.8 million higher than December 31, 2016. This increase is due to the impact of cost inflation, the addition of Grand Itasca and the HealthEast System, higher health insurance reserves needed for employee growth, in addition to both provider growth and higher professional liability claims.

The System's debt totaled \$1,411.1 million, a \$406.5 million increase from December 31, 2016 primarily due to the addition of debt held by Grand Itasca and HealthEast at the time of acquisition on January 1, 2017 and June 1, 2017, respectively. In August 2017, Fairview issued \$388.5 million of tax-exempt and taxable bonds to refund the existing Grand Itasca and the HealthEast System debt obligations, and was able to do so at lower interest rates than the original debt. These issuances resulted in a \$9.5 million loss on early extinguishment of debt, but the System will experience annual interest cost savings on this debt going forward.

The debt to capitalization ratio at December 31, 2017 was 36.4% compared to 33.7% as of December 31, 2016. The increase in leverage and debt is due to the additional debt of \$406.5 million primarily from the acquisition of Grand Itasca and the HealthEast System, offset by consolidated excess of revenues over expenses of \$466.0 million driven by the gain on acquisitions of Grand Itasca and the HealthEast System.

### **Financial Summary**

The System management team expects to drive improved combined financial performance by pursuing growth opportunities across service lines and shared service opportunities, including specialty pharmacy, driving efficiencies by eliminating redundant costs and rationalizing capital across the System to avoid duplicate spend. Management anticipates deriving significant synergies over the next several years from the HealthEast System merger and expects to achieve the full value of these synergy efforts in 2020. Management has already identified savings and growth opportunities in 2017 that are in the process of being implemented, with synergies starting to take place in 2018.

## **Section Five – Investment and Debt Schedule**

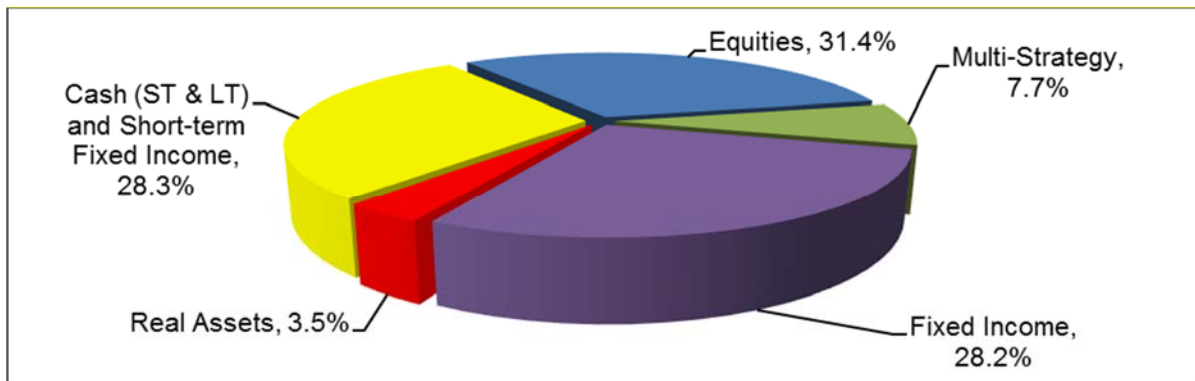
Fairview Health Services  
Investment and Debt Schedule  
(Dollars in Thousands)

**Investment Asset Allocation**

The composition of the System's unrestricted cash and investments includes cash, money market funds, short-term fixed income and various long-term investments. The System's primary investment objectives are to ensure preservation of capital, sufficient operating liquidity and growth. The HealthEast System portfolio, which is included in the tables below, is in the process of transitioning to the System's asset allocation policy. For accounting purposes, the System's investment portfolio is considered "trading".

<b>Unrestricted Cash and Investments</b>	<b>December 31, 2017</b>		<b>December 31, 2016</b>	
Cash and cash equivalents	\$ 51,503	2.2%	\$ 37,300	2.0%
Short-term fixed income investments	616,727	25.9%	491,663	26.1%
<b>Total short-term assets</b>	<b>668,230</b>	<b>28.1%</b>	<b>528,963</b>	<b>28.1%</b>
Long-term investments	1,709,040	71.9%	1,356,524	71.9%
<b>Total unrestricted assets</b>	<b>\$ 2,377,270</b>	<b>100.0%</b>	<b>\$ 1,885,487</b>	<b>100.0%</b>

**Asset Class as a % of Total Unrestricted Investments**



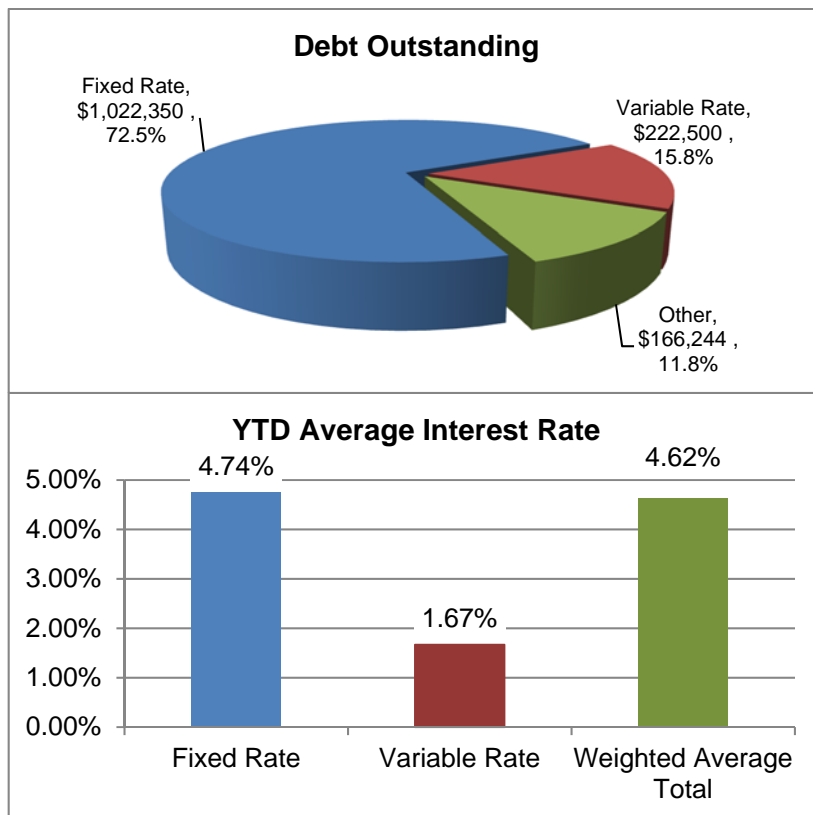
The total unrestricted investment allocation by asset class for the System's long-term investments is summarized as follows:

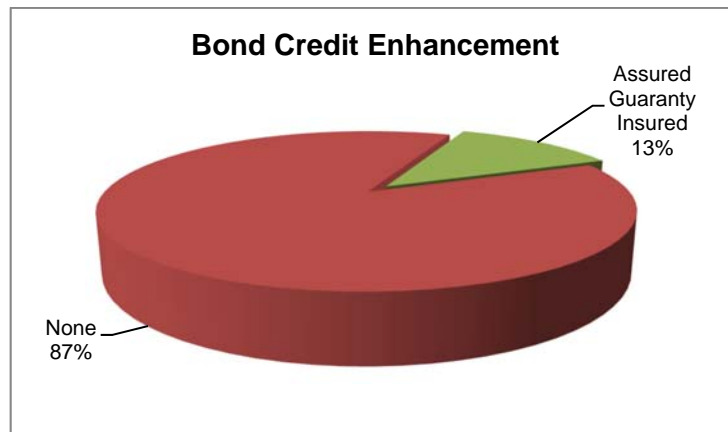
<b>Unrestricted Long-Term Investments</b>	<b>Target Allocation</b>	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Cash	0.0%	1.3%	1.3%
Equities	45.0%	43.7%	44.8%
Fixed Income	35.0%	39.2%	38.1%
Multi-Strategy	15.0%	10.9%	10.9%
Real Assets	5.0%	4.9%	4.9%
<b>Total Long-Term Investments</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

## Debt Structure

The composition of the System's current debt structure (long-term and current maturities), as of December 31, 2017, is summarized below:

Series	Amount Outstanding	Rate Structure	Final Term	Credit Enhancement	YTD Avg Int Rate*
2008B	\$177,165	Fixed	2038	Assured Guaranty Insured	6.50%
2008C**	84,375	Variable	2047	None	1.22%
2008D**	28,125	Variable	2047	None	1.22%
2008E**	110,000	Variable	2047	None	1.22%
2015A	106,945	Fixed	2044	None	4.82%
2015 Taxable	345,315	Fixed	2043	None	4.06%
2017A	202,100	Fixed	2047	None	4.44%
2017B Taxable	95,415	Fixed	2047	None	3.13%
2017C Taxable	95,410	Fixed	2047	None	2.79%
Total	<u>1,244,850</u>			Weighted Average YTD Interest Rate	<u><b>4.62%</b></u>
Other ***	<u>\$166,244</u>				
	<u><b>\$1,411,094</b></u>				





- \* Interest rates are interest cost only, before capitalized interest, and do not include premium/discount, administrative, credit facility, broker or other costs related to the issuance of the bonds.
- \*\* In addition to the variable rate paid, the Direct Purchase bonds are tied to two Floating to Fixed Rate swaps with a net cost of 3.45% (fixed payment of 3.46% less 0.895% variable receipt rate). The total synthetic interest rate on Fairview's Direct Purchase bonds thus totals approximately 3.46%. In accordance with the direct purchase of these bonds, Fairview entered into new agreements that expire in three to five years with a one-year term out provision and debt service fees (credit facility & remarketing fees) were eliminated and "in effect" rolled into the new interest rate.
- \*\*\* Other debt includes capital lease obligations, premium/discounts on fixed rate debt and other miscellaneous notes and loans.