# Interim Unaudited Consolidated Financial Statements and Other Information

For The Period Ended June 30, 2019

**The Cleveland Clinic Foundation**
d.b.a. Cleveland Clinic Health System

## Contents

## Unaudited Consolidated Balance Sheets

*($ in thousands)*

| | June 30 2019 | December 31 2018 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 510,116 | $ 444,763 |
| Patient receivables | 1,276,329 | 1,122,918 |
| Investments for current use | 53,841 | 53,841 |
| Other current assets | 535,257 | 426,465 |
| Total current assets | 2,375,543 | 2,047,987 |
| Investments: | | |
| Long-term investments | 8,272,297 | 7,533,668 |
| Funds held by trustees | 232,356 | 49,377 |
| Assets held for self-insurance | 156,612 | 106,966 |
| Donor restricted assets | 808,119 | 744,851 |
| | 9,469,384 | 8,434,862 |
| Property, plant, and equipment, net | 5,781,251 | 5,072,464 |
| Other assets: | | |
| Pledges receivable, net | 154,653 | 152,448 |
| Trusts and interests in foundations | 110,956 | 87,606 |
| Other noncurrent assets | 730,572 | 411,762 |
| | 996,181 | 651,816 |
| **Total assets** | $ 18,622,359 | $ 16,207,129 |

## Unaudited Consolidated Balance Sheets (continued)

*($ in thousands)*

| | June 30 2019 | December 31 2018 |
|---|---|---|
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Accounts payable | $ 445,846 | $ 527,672 |
| Compensation and amounts withheld from payroll | 450,256 | 359,342 |
| Current portion of long-term debt | 94,977 | 191,350 |
| Variable rate debt classified as current | 531,586 | 407,776 |
| Other current liabilities | 524,599 | 493,453 |
| Total current liabilities | 2,047,264 | 1,979,593 |
| Long-term debt | 4,331,393 | 3,558,911 |
| Other liabilities: | | |
| Professional and general insurance liability reserves | 191,182 | 141,182 |
| Accrued retirement benefits | 507,218 | 465,527 |
| Other noncurrent liabilities | 728,600 | 542,029 |
| | 1,427,000 | 1,148,738 |
| Total liabilities | 7,805,657 | 6,687,242 |
| Net assets: | | |
| Without donor restrictions | 9,649,365 | 8,465,468 |
| With donor restrictions | 1,167,337 | 1,054,419 |
| Total net assets | 10,816,702 | 9,519,887 |
| **Total liabilities and net assets** | $ 18,622,359 | $ 16,207,129 |

See notes to unaudited consolidated financial statements.

## Unaudited Consolidated Statements of Operations and Changes in Net Assets

*($ in thousands)*

### Operations

| | Three Months Ended June 30 | |
|---|---|---|
| | 2019 | 2018 |
| **Unrestricted revenues** | | |
| Net patient service revenue | $2,395,514 | $1,987,206 |
| Other | 256,963 | 221,036 |
| Total unrestricted revenues | 2,652,477 | 2,208,242 |
| **Expenses** | | |
| Salaries, wages, and benefits | 1,430,547 | 1,225,495 |
| Supplies | 256,737 | 213,842 |
| Pharmaceuticals | 321,453 | 272,344 |
| Purchased services and other fees | 153,317 | 142,493 |
| Administrative services | 56,349 | 56,052 |
| Facilities | 94,270 | 89,323 |
| Insurance | 24,832 | 22,447 |
| | 2,337,505 | 2,021,996 |
| **Operating income before interest, depreciation, and amortization expenses** | 314,972 | 186,246 |
| Interest | 39,454 | 34,489 |
| Depreciation and amortization | 159,330 | 125,702 |
| **Operating income before special charges** | 116,188 | 26,055 |
| Special charges | - | 954 |
| **Operating income** | 116,188 | 25,101 |
| **Nonoperating gains and losses** | | |
| Investment return | 181,692 | (831) |
| Derivative (losses) gains | (33,819) | 5,691 |
| Other, net | (37,550) | 50,750 |
| Net nonoperating gains and losses | 110,323 | 55,610 |
| **Excess of revenues over expenses** | 226,511 | 80,711 |

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

*($ in thousands)*

### Changes in Net Assets

| | Three Months Ended June 30 | |
|---|---|---|
| | 2019 | 2018 |
| **Changes in net assets without donor restrictions:** | | |
| Excess of revenues over expenses | $226,511 | $80,711 |
| Donated capital | - | 460 |
| Net assets released from restriction for capital purposes | 35,951 | 469 |
| Retirement benefits adjustment | (3,621) | (717) |
| Foreign currency translation | 373 | (22,846) |
| Other | (150) | (879) |
| Increase in net assets without donor restrictions | 259,064 | 57,198 |
| **Changes in net assets with donor restrictions:** | | |
| Gifts and bequests | 24,315 | 21,213 |
| Net investment income | 16,265 | 1 |
| Net assets released from restrictions used for operations included in other unrestricted revenues | (11,971) | (9,941) |
| Net assets released from restriction for capital purposes | (35,951) | (469) |
| Change in interests in foundations | 324 | (54) |
| Change in value of perpetual trusts | 925 | 268 |
| Member substitution contribution | (1,250) | 13,180 |
| Other | 96 | 83 |
| (Decrease) increase in net assets with donor restrictions | (7,247) | 24,281 |
| Increase in net assets | 251,817 | 81,479 |
| Net assets at beginning of period | 10,564,885 | 9,474,837 |
| Net assets at end of period | $ 10,816,702 | $ 9,556,316 |

See notes to unaudited consolidated financial statements.

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

*($ in thousands)*

### Operations

| | Six Months Ended June 30 | |
|---|---|---|
| | 2019 | 2018 |
| **Unrestricted revenues** | | |
| Net patient service revenue | $ 4,678,399 | $ 3,896,980 |
| Other | 496,417 | 433,713 |
| Total unrestricted revenues | 5,174,816 | 4,330,693 |
| **Expenses** | | |
| Salaries, wages, and benefits | 2,841,704 | 2,408,715 |
| Supplies | 505,957 | 417,041 |
| Pharmaceuticals | 623,352 | 526,569 |
| Purchased services and other fees | 317,932 | 270,753 |
| Administrative services | 105,573 | 96,029 |
| Facilities | 190,039 | 174,553 |
| Insurance | 50,066 | 42,321 |
| | 4,634,623 | 3,935,981 |
| **Operating income before interest, depreciation, amortization, and special charges** | 540,193 | 394,712 |
| Interest | 79,205 | 67,490 |
| Depreciation and amortization | 308,598 | 252,757 |
| **Operating income before special charges** | 152,390 | 74,465 |
| Special charges | - | 1,788 |
| **Operating income** | 152,390 | 72,677 |
| **Nonoperating gains and losses** | | |
| Investment return | 553,332 | 36,273 |
| Derivative (loss) income | (42,306) | 21,107 |
| Other, net | 482,471 | 57,126 |
| Net nonoperating gains and losses | 993,497 | 114,506 |
| **Excess of revenues over expenses** | 1,145,887 | 187,183 |

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

*($ in thousands)*

### Changes in Net Assets

| | Six Months Ended June 30 | |
|---|---|---|
| | 2019 | 2018 |
| **Changes in net assets without donor restrictions:** | | |
| Excess of revenues over expenses | $ 1,145,887 | $ 187,183 |
| Donated capital | - | 460 |
| Net assets released from restriction for capital purposes | 39,598 | 1,066 |
| Retirement benefits adjustment | (2,298) | (1,432) |
| Foreign currency translation | 830 | (9,846) |
| Other | (120) | (829) |
| Increase in net assets without donor restrictions | 1,183,897 | 176,602 |
| **Changes in net assets with donor restrictions:** | | |
| Gifts and bequests | 59,785 | 46,422 |
| Net investment income | 42,273 | 201 |
| Net assets released from restrictions used for operations included in other unrestricted revenues | (21,059) | (23,392) |
| Net assets released from restriction for capital purposes | (39,598) | (1,066) |
| Change in interests in foundations | 1,332 | (54) |
| Change in value of perpetual trusts | 343 | 898 |
| Member substitution contribution | 69,738 | 13,180 |
| Other | 104 | 72 |
| Increase in net assets with donor restrictions | 112,918 | 36,261 |
| Increase in net assets | 1,296,815 | 212,863 |
| Net assets at beginning of year | 9,519,887 | 9,343,453 |
| Net assets at end of period | $ 10,816,702 | $ 9,556,316 |

See notes to unaudited consolidated financial statements.

## Unaudited Consolidated Statements of Cash Flows

*($ in thousands)*

| | Six Months Ended June 30 | |
|---|---|---|
| | 2019 | 2018 |
| **Operating activities and net nonoperating gains and losses** | | |
| Increase in net assets | $ 1,296,815 | $ 212,863 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities and net nonoperating gains and losses: | | |
| Loss on extinguishment of debt | 17,263 | - |
| Retirement benefits adjustment | 2,298 | 1,432 |
| Net realized and unrealized gains on investments | (563,629) | (11,280) |
| Depreciation and amortization | 308,598 | 254,352 |
| Foreign currency translation (gain) loss | (830) | 9,846 |
| Donated capital | - | (460) |
| Restricted gifts, bequests, investment income, and other | (103,733) | (47,467) |
| Accreted interest and amortization of bond premiums | (2,618) | (3,055) |
| Net loss (gain) in value of derivatives | 34,737 | (29,658) |
| Member substitution contribution | (571,465) | (65,442) |
| Changes in operating assets and liabilities: | | |
| Patient receivables | (46,897) | (75,589) |
| Other current assets | (38,944) | (19,819) |
| Other noncurrent assets | (248,635) | 33,576 |
| Accounts payable and other current liabilities | (21,472) | 3,916 |
| Other liabilities | 132,121 | (15,741) |
| Net cash provided by operating activities and net nonoperating gains and losses | 193,609 | 247,474 |
| **Financing activities** | | |
| Proceeds from long-term borrowings | 998,906 | 45,000 |
| Payments for redemption of long-term debt | (271,009) | - |
| Principal payments on long-term debt | (284,506) | (117,373) |
| Debt issuance costs | (6,559) | - |
| Change in pledges receivables, trusts and interests in foundations | 2,623 | (6,533) |
| Restricted gifts, bequests, investment income, and other | 103,733 | 47,467 |
| Net cash provided by (used in) financing activities | 543,188 | (31,439) |
| **Investing activities** | | |
| Expenditures for property, plant and equipment | (527,004) | (356,631) |
| Proceeds from sale of property, plant and equipment | 59,749 | - |
| Net change in cash equivalents reported in long-term investments | (272,209) | 252,518 |
| Purchases of investments | (3,095,991) | (1,255,992) |
| Sales of investments | 3,146,439 | 1,163,279 |
| Member substitution cash contribution | 16,402 | 1,515 |
| Net cash used in investing activities | (672,614) | (195,311) |
| Effect of exchange rate changes on cash | 1,170 | (2,134) |
| Increase in cash and cash equivalents | 65,353 | 18,590 |
| Cash and cash equivalents at beginning of year | 444,763 | 241,227 |
| Cash and cash equivalents at end of period | $ 510,116 | $ 259,817 |

See notes to unaudited consolidated financial statements.

## 1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal and recurring nature. For further information, refer to the audited financial statements and notes thereto for the year ended December 31, 2018.

## 2. Organization and Consolidation

The Cleveland Clinic Foundation (Clinic) is a nonprofit, tax-exempt, Ohio corporation organized and operated to provide medical and hospital care, medical research, and education. The accompanying consolidated financial statements include the accounts of the Clinic and its controlled affiliates, d.b.a. Cleveland Clinic Health System (System).

The System is the leading provider of healthcare services in northeast Ohio. The System operates 18 hospitals with approximately 4,900 staffed beds. Thirteen of the hospitals are operated in the Northeast Ohio area, anchored by the Clinic. The System operates 21 outpatient family health centers, 11 ambulatory surgery centers, as well as numerous physician offices, which are located throughout northeast Ohio, and specialized cancer centers in Sandusky and Mansfield, Ohio. In Florida, the System operates 5 hospitals and a clinic located throughout Southeast Florida, outpatient family health centers in West Palm Beach and St. Lucie, an outpatient family health and ambulatory surgery center in Coral Springs and numerous physician offices located throughout Southeast Florida. In addition, the System operates a health and wellness center and a sports medicine clinic in Toronto, Canada and a specialized neurological clinical center in Las Vegas, Nevada. Pursuant to agreements, the System also provides management services for Ashtabula County Medical Center, located in Ashtabula, Ohio, with approximately 180 staffed beds, and Cleveland Clinic Abu Dhabi, a multispecialty hospital offering critical and acute care services that is part of Mubadala Development Company's network of healthcare facilities located in Abu Dhabi, United Arab Emirates with approximately 364 staffed beds.

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

## 3. Business Combinations

Effective January 1, 2019, the Clinic through a subsidiary became the sole member of Martin Memorial Health Systems, Inc. (Martin) and Indian River Memorial Hospital, Inc. (Indian River) through non-cash business combination transactions. The business combinations were recorded under the acquisition method of accounting. The System recorded the fair value of the assets acquired of $1,118 million and the liabilities assumed of $547 million as of January 1, 2019. The fair value of net assets of $571 million was recognized in the consolidated statement of operations and changes in net assets for the six months ended June 30, 2019 as a member substitution contribution of $502 million included in other nonoperating gains and losses and contributions of net assets with donor restrictions of $69 million. The accounting for the business combinations represents estimated fair values of assets acquired and liabilities assumed based on preliminary information and is subject to change as the System completes the valuation analysis. The valuation is expected to be completed by the end of 2019.

## 3. Business Combinations (continued)

The results of operations for Martin and Indian River are included in the consolidated statements of operations and changes in net assets beginning on January 1, 2019. For the six months ended June 30, 2019, Martin had total unrestricted revenues of $313.6 million, operating loss of $3.4 million and a deficiency of revenues over expenses of $4.9 million. For the six months ended June 30, 2019, Indian River had total unrestricted revenues of $165.4 million, operating income of $3.2 million and an excess of revenues over expenses of $3.7 million. The operations of Martin and Indian River did not have a material impact on changes in net assets with donor restrictions.

## 4. Accounting Policies

### Recent Accounting Pronouncements

*Adopted*

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU requires lessees to recognize assets and liabilities on the balance sheet for leases with lease terms greater than twelve months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. This amends current guidance that requires only finance leases to be recognized on the lessee balance sheet. ASU 2016-02 also requires additional disclosures on the amount, timing and uncertainty of cash flows arising from leases. The System adopted ASU 2016-02 on January 1, 2019 using a modified retrospective approach. The impact of adoption on the consolidated financial statements resulted in an increase in other noncurrent assets to record right-of-use assets and an increase in other current and noncurrent liabilities to record lease obligations for operating leases of approximately $380 million representing the present value of remaining lease payments for operating leases. The adoption of ASU 2016-02 did not have a material impact on excess of revenues over expenses or net assets.

*Not Yet Adopted*

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU intends to clarify and improve current accounting guidance to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. The ASU is effective for the System for annual reporting periods beginning after June 15, 2018 for contributions received and after December 15, 2018 for contributions made, and interim periods beginning after December 31, 2019 with early adoption permitted. The System is currently assessing the impact that ASU 2018-08 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

## 4. Accounting Policies (continued)

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU intends to improve the effectiveness of disclosures in the notes to financial statements by modifying disclosure requirements for fair value measurements. The ASU is effective for the System for annual and interim reporting periods beginning after December 15, 2019 with early adoption permitted. The System is currently assessing the impact that ASU 2018-13 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

In August 2018, the FASB issued ASU No. 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General, Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans*. This ASU intends to improve the effectiveness of disclosures in the notes to financial statements by modifying disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The ASU is effective for the System for annual reporting periods ending after December 15, 2021 with early adoption permitted. The System is currently assessing the impact that ASU 2018-14 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*. This ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The ASU is effective for the System for annual reporting periods beginning after December 15, 2020, and interim periods beginning after December 15, 2021 with early adoption permitted. The System is currently assessing the impact that ASU 2018-15 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

## 5. Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

## 6. Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled for providing patient care. These amounts are due from patients, third-party payors, and others and includes variable consideration for retroactive revenue adjustments due to settlement of reviews and audits. Generally, the System bills the patients and third-party payors several days after the services are performed or shortly after discharge. Revenue is recognized as performance obligations are satisfied.

## 6. Net Patient Service Revenue (continued)

Performance obligations are determined based on the nature of the services provided by the System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. The System believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services. The System measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. These services are considered to be a single performance obligation. Revenue for performance obligations satisfied at a point in time is recognized when services are provided and the System does not believe it is required to provide additional services to the patient.

Because all of its performance obligations relate to contracts with a duration of less than one year, the System has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The System is utilizing the portfolio approach practical expedient in ASC 606 for contracts related to net patient service revenue. The System accounts for the contracts within each portfolio as a collective group, rather than individual contracts, based on the payment pattern expected in each portfolio category and the similar nature and characteristics of the patients within each portfolio. The portfolios consist of major payor classes for inpatient revenue and outpatient revenue. Based on historical collection trends and other analyses, the System has concluded that revenue for a given portfolio would not be materially different than if accounting for revenue on a contract-by-contract basis.

The System has agreements with third-party payors that generally provide for payments to the System at amounts different from its established rates. For uninsured patients who do not qualify for charity care, the System recognizes revenue based on established rates, subject to certain discounts and implicit price concessions as determined by the System. The System determines the transaction price based on standard charges for services provided, reduced by explicit price concessions provided to third-party payors, discounts provided to uninsured patients in accordance with the System's policy, and implicit price concessions provided to uninsured patients. Explicit price concessions are based on contractual agreements, discount policies and historical experience. Implicit price concessions represent differences between amounts billed and the estimated consideration the System expects to receive from patients, which are determined based on historical collection experience, current market conditions and other factors.

## 6. Net Patient Service Revenue (continued)

Generally, patients who are covered by third-party payors are responsible for patient responsibility balances, including deductibles and coinsurance, which vary in amount. The System estimates the transaction price for patients with deductibles and coinsurance based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any explicit price concessions, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Adjustments arising from a change in the transaction price increased net patient service revenue by $40.2 million in the first six months of 2019. Adjustments arising from a change in the transaction price were not significant in the first six months of 2018

The System is paid a prospectively determined rate for the majority of inpatient acute care and outpatient, skilled nursing, and rehabilitation services provided (principally Medicare, Medicaid, and certain insurers). These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for capital are received on a prospective basis for Medicare and on a cost reimbursement methodology for Medicaid. Payments are received on a prospective basis for the System's medical education costs, subject to certain limits. The System is paid for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare Administrative Contractor.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation as well as significant regulatory action, and, in the normal course of business, the System is subject to contractual reviews and audits, including audits initiated by the Medicare Recovery Audit Contractor program. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term. The System believes it is in compliance with applicable laws and regulations governing the Medicare and Medicaid programs and that adequate provisions have been made for any adjustments that may result from final settlements.

Settlements with third-party payors for retroactive adjustments due to reviews and audits are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care in the period the related services are provided. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the System's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known or as years are settled or are no longer subject to such reviews and audits. Adjustments arising from a change in estimated settlements were not significant in the first six months of 2019 and 2018.

The System provides care to patients who do not have the ability to pay and who qualify for charity care pursuant to established policies of the System. Charity care is defined as services for which patients have the obligation and willingness to pay but do not have the ability to do so. The System does not report charity care as net patient service revenue.

## 6. Net Patient Service Revenue (continued)

Net patient service revenue by major payor source, net of price concessions, for the six months ended June 30, 2019 and 2018, is as follows (in thousands):

| | 2019 | | 2018 | |
|---|---|---|---|---|
| Medicare | **$ 1,841,442** | **39%** | $ 1,433,471 | 37% |
| Medicaid | **407,320** | **9** | 325,105 | 8 |
| Managed care and commercial | **2,407,257** | **51** | 2,124,088 | 55 |
| Self-pay | **22,380** | **1** | 14,316 | - |
| Net patient service revenue | **$ 4,678,399** | **100%** | $ 3,896,980 | 100% |

## 7. Fair Value Measurements

Fair value measurements are defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Authoritative guidance provides an option to elect fair value as an alternative measurement for selected financial assets and liabilities not previously recorded at fair value. The System did not elect fair value accounting for any assets or liabilities that are not currently required to be measured at fair value.

The framework for measuring fair value is comprised of a three-level hierarchy based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

## 7. Fair Value Measurements (continued)

The following tables present the financial instruments measured at fair value on a recurring basis as of June 30, 2019 and December 31, 2018, based on the valuation hierarchy (in thousands):

| **June 30, 2019** | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and investments: | | | | |
| Cash and cash equivalents | **$ 1,461,676** | **$ 56** | $ – | **$ 1,461,732** |
| Fixed income securities: | | | | |
| U.S. treasuries | **1,135,526** | **–** | **–** | **1,135,526** |
| U.S. government agencies | **–** | **30,723** | **–** | **30,723** |
| U.S. corporate | **–** | **314,800** | **–** | **314,800** |
| U.S. government agencies asset-backed securities | **–** | **248,471** | **–** | **248,471** |
| Corporate asset-backed securities | **–** | **117,563** | **–** | **117,563** |
| Foreign | **–** | **130,562** | **–** | **130,562** |
| Fixed income mutual funds | **118,459** | **–** | **–** | **118,459** |
| Common and preferred stocks: | | | | |
| U.S. | **365,445** | **500** | **–** | **365,945** |
| Foreign | **333,832** | **5,456** | **–** | **339,288** |
| Equity mutual funds | **117,489** | **–** | **–** | **117,489** |
| Total cash and investments | **3,532,427** | **848,131** | **–** | **4,380,558** |
| Perpetual and charitable trusts | **–** | **86,009** | **–** | **86,009** |
| Total assets at fair value | **$ 3,532,427** | **$ 934,140** | $ – | **$ 4,466,567** |
| **Liabilities** | | | | |
| Interest rate swaps | $ – | **$ 133,594** | $ – | **$ 133,594** |
| Foreign currency forward contracts | **–** | **14,289** | **–** | **14,289** |
| Total liabilities at fair value | $ – | **$ 147,883** | $ – | **$ 147,883** |

## 7. Fair Value Measurements (continued)

| December 31, 2018 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and investments: | | | | |
| Cash and cash equivalents | $ 911,624 | $ 253 | $ – | $ 911,877 |
| Fixed income securities: | | | | |
| U.S. treasuries | 1,385,156 | – | – | 1,385,156 |
| U.S. government agencies | – | 20,889 | – | 20,889 |
| U.S. corporate | – | 108,240 | – | 108,240 |
| U.S. government agencies asset-backed securities | – | 94,399 | – | 94,399 |
| Corporate asset-backed securities | – | 31,477 | – | 31,477 |
| Foreign | – | 54,132 | – | 54,132 |
| Fixed income mutual funds | 122,034 | – | – | 122,034 |
| Common and preferred stocks: | | | | |
| U.S. | 425,269 | – | – | 425,269 |
| Foreign | 288,773 | 3,862 | – | 292,635 |
| Equity mutual funds | 97,932 | – | – | 97,932 |
| Total cash and investments | 3,230,788 | 313,252 | – | 3,544,040 |
| Perpetual and charitable trusts | – | 63,991 | – | 63,991 |
| Total assets at fair value | $ 3,230,788 | $ 377,243 | $ – | $ 3,608,031 |
| **Liabilities** | | | | |
| Interest rate swaps | $ – | $ 101,444 | $ – | $ 101,444 |
| Foreign currency forward contracts | $ – | $ 9,419 | $ – | $ 9,419 |
| Total liabilities at fair value | $ – | $ 110,863 | $ – | $ 110,863 |

## 7. Fair Value Measurements (continued)

Financial instruments at June 30, 2019 and December 31, 2018 are reflected in the consolidated balance sheets as follows (in thousands):

| | June 30 2019 | December 31 2018 |
|---|---|---|
| Cash, cash equivalents, and investments measured at fair value | **$ 4,380,558** | $ 3,544,040 |
| Commingled funds measured at net asset value | **2,681,832** | 2,654,193 |
| Alternative investments accounted for under the equity method | **2,970,951** | 2,735,233 |
| Total cash, cash equivalents, and investments | **$ 10,033,341** | $ 8,933,466 |
| | | |
| Perpetual and charitable trusts measured at fair value | **$ 86,009** | $ 63,991 |
| Interests in foundations | **24,947** | 23,615 |
| Trusts and interests in foundations | **$ 110,956** | $ 87,606 |

Interest rate swaps and foreign currency forward contracts (*Note 8*) are reported in other current and noncurrent liabilities in the consolidated balance sheets.

The following is a description of the System's valuation methodologies for assets and liabilities measured at fair value. Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is determined as follows:

Investments classified as Level 2 are primarily determined using techniques that are consistent with the market approach. Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs, which include broker/dealer quotes, reported/comparable trades, and benchmark yields, are obtained from various sources, including market participants, dealers, and brokers.

The fair value of perpetual and charitable trusts in which the System receives periodic payments from the trust is determined based on the present value of expected cash flows to be received from the trust using discount rates ranging from 2.8% to 5.0%, which are based on Treasury yield curve interest rates or the assumed yield of the trust assets. The fair value of charitable trusts in which the System is a remainder beneficiary is based on the System's beneficial interest in the investments held in the trust, which are measured at fair value.

## 7. Fair Value Measurements (continued)

The fair value of interest rate swaps is determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved. The valuations include a credit spread adjustment to market interest rate curves to appropriately reflect nonperformance risk. The credit spread adjustment is derived from other comparably rated health care entities' bonds. The System manages credit risk based on the net portfolio exposure with each counterparty.

The fair value of foreign currency forward contracts is based on the difference between the contracted exchange rate and current market foreign currency exchange rates adjusted for forward points, which are differences in prevailing deposit interest rates between each currency through the remaining term of the contract.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

## 8. Derivative Instruments

The System has entered into various derivative financial instruments to manage interest rate risk and foreign currency exposures.

The System's objective with respect to interest rate risk is to manage the risk of rising interest rates on the System's variable rate debt. Consistent with its interest rate risk management objective, the System entered into various interest rate swap agreements with a total outstanding notional amount of $623.3 million and $618.2 million at June 30, 2019 and December 31, 2018, respectively. During the term of these transactions, the System pays interest at a fixed rate and receives interest at a variable rate based on the London Interbank Offered Rate (LIBOR) or the Securities Industry and Financial Markets Association Index (SIFMA). The swap agreements are not designated as hedging instruments. Net interest paid or received under the swap agreements is included in derivative losses in the consolidated statements of operations and changes in net assets.

## 8. Derivative Instruments (continued)

The following table summarizes the System's interest rate swap agreements (in thousands):

| Swap Type | Expiration Date | System Pays | System Receives | | Notional Amount at June 30 2019 | Notional Amount at December 31 2018 |
|---|---|---|---|---|---|---|
| Fixed | 2021 | 3.21% | 68% | of LIBOR | **$ 28,525** | $ 30,145 |
| Fixed | 2024 | 3.42% | 68% | of LIBOR | **25,700** | 26,500 |
| Fixed | 2024 | 3.45% | 67% | of LIBOR | **7,290** | – |
| Fixed | 2027 | 3.56% | 68% | of LIBOR | **115,757** | 120,113 |
| Fixed | 2028 | 5.12% | 100% | of LIBOR | **35,430** | 36,605 |
| Fixed | 2028 | 3.51% | 68% | of LIBOR | **27,395** | 28,285 |
| Fixed | 2030 | 5.07% | 100% | of LIBOR | **57,250** | 57,250 |
| Fixed | 2030 | 5.06% | 100% | of LIBOR | **57,225** | 57,225 |
| Fixed | 2031 | 3.04% | 68% | of LIBOR | **44,000** | 46,975 |
| Fixed | 2032 | 4.32% | 79% | of LIBOR | **2,141** | 2,189 |
| Fixed | 2032 | 4.33% | 70% | of LIBOR | **4,283** | 4,377 |
| Fixed | 2032 | 3.78% | 70% | of LIBOR | **2,141** | 2,189 |
| Fixed | 2032 | 3.58% | 67% | of LIBOR | **10,590** | – |
| Fixed | 2036 | 4.90% | 100% | of LIBOR | **49,125** | 49,125 |
| Fixed | 2036 | 4.90% | 100% | of LIBOR | **76,125** | 76,950 |
| Fixed | 2037 | 4.62% | 100% | of SIFMA | **59,115** | 59,115 |
| Fixed | 2039 | 4.62% | 68% | of LIBOR | **21,170** | 21,170 |
| | | | | | **$ 623,262** | $ 618,213 |

The System is exposed to fluctuations in various foreign currencies against its functional currency, the U.S. dollar (USD). The System uses foreign currency forward contracts to manage its exposure to fluctuations in the USD – British Pound (GBP) exchange rate. Currency forward contracts involve fixing the USD – GBP exchange rate for delivery of a specified amount of foreign currency on a specified date. The currency forward contracts are typically cash settled in USD for their fair value at or close to their settlement date.

In November 2018, the System entered into three foreign currency forward contracts, expiring between May 2020 and April 2021, with a total outstanding notional amount of $336.2 million at June 30, 2019 and December 31, 2018. The foreign currency forward contracts are not designated as hedging instruments.

## 8. Derivative Instruments (continued)

The following table summarizes the location and fair value for the System's derivative instruments (in thousands):

| | Derivatives Liability | | | |
|---|---|---|---|---|
| | June 30, 2019 | | December 31, 2018 | |
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| **Derivatives not designated as hedging instruments** | | | | |
| Interest rate swap agreements | Other noncurrent liabilities | **$ 133,594** | Other noncurrent liabilities | $ 101,444 |
| Foreign currency contracts | Other noncurrent liabilities | **$ 9,079** | Other noncurrent liabilities | $ 9,419 |
| Foreign currency contracts | Other current liabilities | **$ 5,210** | Other current liabilities | $ – |

The following table summarizes the location and amounts of derivative losses (gains) on the System's interest rate swap agreements (in thousands):

| Derivatives not designated as hedging instruments | Location of Gain (Loss) Recognized | Quarter ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|---|
| | | 2019 | 2018 | 2019 | 2018 |
| Interest rate swap agreements | Derivative (losses) gains | **$ (22,783)** | $ 5,691 | **$ (37,436)** | $ 21,107 |
| Foreign currency contracts | Derivative losses | **$ (11,036)** | - | **(4,870)** | - |
| | | **$ (33,819)** | $ 5,691 | **$ (42,306)** | $ 21,107 |

The System has used various derivative contracts in connection with certain prior obligations and investments. Although minimum credit ratings are required for counterparties, this does not eliminate the risk that a counterparty may fail to honor its obligations. Derivative contracts are subject to periodic "mark-to-market" valuations. A derivative contract may, at any time, have a positive or negative value to the System. In the event that the negative value reaches certain thresholds established in the derivative contracts, the System is required to post collateral, which could adversely affect its liquidity. At June 30, 2019 and December 31, 2018, the System posted $68.4 million and $49.0 million, respectively, of collateral with counterparties that is included in funds held by trustees in the consolidated balance sheets. In addition, if the System were to choose to terminate a derivative contract or if a derivative contract were terminated pursuant to an event of default or a termination event as described in the derivative contract, the System could be required to pay a termination payment to the counterparty.

## 9. Pensions and Other Postretirement Benefits

The System maintains five defined benefit pension plans, including two plans related to Akron General and one plan related to Indian River. The CCHS Retirement Plan is a tax-qualified defined benefit pension plan that provides benefits to substantially all employees of the System, except those employed by Akron General, Union Hospital or Indian River. All benefit accruals under the CCHS Retirement Plan ceased as of December 31, 2012. Akron General has a tax-qualified defined benefit plan covering substantially all of its employees that were hired before 2004 who meet certain eligibility requirements. All benefit accruals under the Akron General defined benefit plan ceased as of December 31, 2017. Indian River has a tax-qualified defined benefit plan covering substantially all of its employees that were hired before December 31, 2002 who meet certain eligibility requirements. All benefit accruals under the Indian River defined benefit plan ceased as of December 31, 2002. Martin had a tax-qualified defined benefit plan covering substantially all of its employees that were hired before October 1, 2005 who met certain eligibility requirements. All benefit accruals under the Martin defined benefit plan ceased as of January 1, 2013. On June 30, 2019 the Martin defined benefit pension plan merged with the CCHS Retirement Plan, with the CCHS Retirement plan being a single continuing pension plan. The benefits for the System's tax-qualified defined benefit pension plans are provided based on age, years of service, and compensation. The System's policy for its tax-qualified defined benefit pension plans is to fund at least the minimum amounts required by the Employee Retirement Income Security Act. The System also maintains two unfunded, nonqualified defined benefit supplemental retirement plans, which cover certain professional staff and administrative employees.

The System sponsors two noncontributory, defined contribution plans, and six contributory, defined contribution plans covering System, Akron General and Union Hospital employees. The System also assumed two additional contributory, defined contribution plans from the Martin and Indian River member substitutions in January 2019. The Cleveland Clinic Investment Pension Plan (IPP) is a noncontributory, defined contribution plan, which covers substantially all of the System's employees, except employees covered by the Cleveland Clinic Cash Balance Plan and those employed by Akron General, Union Hospital, Martin or Indian River. The System's contribution to the IPP for participants is based upon a percentage of employee compensation that is based on years of service. The Cleveland Clinic Cash Balance Plan (CBP) is a noncontributory, defined contribution plan that covers certain professional and administrative employees not covered by the IPP. The System's contribution to the CBP is a percentage of employee compensation that is determined according to age. The System sponsors eight tax-qualified contributory, defined contribution plans, which collectively cover substantially all employees. The plans permit employees to make pretax employee deferrals and to become entitled to certain employer matching contributions that are based on employee contributions.

## 9. Pensions and Other Postretirement Benefits (continued)

The components of net periodic benefit cost for defined benefit pension plans are as follows (in thousands):

| | Quarter Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | **2019** | **2018** | **2019** | **2018** |
| Amounts related to defined benefit pension plans: | | | | |
| Service cost | $ (855) | $ (378) | $ (1,711) | $ (757) |
| Interest cost | 19,393 | 16,178 | 38,786 | 32,356 |
| Expected return on assets | (21,410) | (18,697) | (42,821) | (37,393) |
| Net amortization and deferral | (478) | (478) | (955) | (955) |
| Total defined benefit pension plans | (3,350) | (3,375) | (6,701) | (6,749) |
| Defined contribution plans | 71,744 | 64,898 | 143,456 | 129,595 |
| | **$ 68,394** | **$ 61,523** | **$ 136,755** | **$ 122,846** |

The service cost component of net periodic benefit cost is included in salaries, wages, and benefits in the consolidated statements of operations. The components of net periodic benefit cost other than the service cost component are included in other nonoperating gains and losses in the consolidated statements of operations.

As of June 30, 2019, the System has made contributions of $6.9 million to the defined benefit pension plans. The System is scheduled to make additional contributions of $5.7 million to the defined benefit pension plans for the remainder of 2019, although the System is currently evaluating pension funding levels and may make additional contributions to the plans before the end of 2019.

## 10. Leases

The System has operating and finance leases for real estate, personal property and equipment. The System determines if an arrangement is a lease at the inception of a contract. Operating lease right-of-use assets are included in other noncurrent assets and operating lease liabilities are included in other current and noncurrent liabilities in the consolidated balance sheets. The System had right-of-use assets and lease liabilities for operating leases totaling approximately $245 million at June 30, 2019. Finance lease right-of-use assets are included in property, plant and equipment, and the related lease liabilities are included in current portion of long-term debt and long-term debt in the consolidated balance sheets. The System had right-of-use assets and lease liabilities for finance leases totaling approximately $112 million and $119 million, respectively, at June 30, 2019. Right-of-use assets obtained in exchange for new operating and finance leases were not significant for the six months ending June 30, 2019. Leases with an initial term of twelve months or less are not recorded in the balance sheet.

## 10. Leases (continued)

The System has lease agreements which require payments for lease and non-lease components and has elected to account for these as a single lease component. For leases that commenced before the effective date of ASU 2016-12, the System elected the permitted practical expedients to not reassess the following: (i) whether any expired or existing contracts contain leases; (ii) the lease classification for any expired or existing leases; and (iii) initial direct costs for any existing leases.

Right-of-use assets represent the System's right to use an underlying asset during the lease term and lease liabilities represent the System's obligation to make lease payments arising from the lease. Right-of-use assets and liabilities are recognized at the commencement date based on the net present value of fixed lease payments over the lease term. The System's lease terms include options to extend or terminate the lease when it is reasonably certain that the options will be exercised. As most of the System's operating leases do not provide an implicit rate, the System uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The System considers recent debt issuances as well as publicly available data for instruments with similar characteristics when calculating its incremental borrowing rates. Finance lease agreements generally include an interest rate that is used to determine the present value of future lease payments. Operating fixed lease expense and finance lease depreciation expense are recognized on a straight-line basis over the lease term.

Operating expenses for the leasing activity of the System as lessee for the six months ending June 30, 2019 are as follows (in thousands):

| | Classification | Amount |
|---|---|---|
| Operating lease expense | Facilities expense | $ 29,459 |
| Financing lease interest | Interest expense | 2,750 |
| Financing lease amortization | Depreciation and amortization | 13,553 |
| Total lease cost | | $ 57,275 |

Supplemental cash flow information is as follows (in thousands):

| | Six Months Ended June 30, 2019 |
|---|---|
| Cash paid for amounts included in the measurement of lease liabilities: | |
| Operating cash flows from operating leases | $ 28,563 |
| Operating cash flows from finance leases | 2,750 |
| Financing cash flows from finance leases | 12,187 |
| Total | $ 31,832 |

## 10. Leases (continued)

The aggregate future lease payments for operating and finance leases as of June 30, 2019 were as follows (in millions):

| | Operating | Finance |
|---|---|---|
| 2019 (excluding the six months ending June 30, 2019) | $ 22,733 | $ 14,575 |
| 2020 | 39,612 | 25,774 |
| 2021 | 34,648 | 21,720 |
| 2022 | 29,449 | 16,862 |
| 2023 | 24,435 | 11,915 |
| Thereafter | 1,266,773 | 50,114 |
| Total lease payments | 1,417,650 | 140,960 |
| Less: Interest | (1,172,691) | (21,849) |
| Present value of lease liabilities | $ 244,959 | $ 119,111 |

Average lease terms and discount rates were as follows:

| | June 30, 2019 |
|---|---|
| Weighted-average remaining lease term (years): | |
| Operating leases | 62.6 |
| Finance leases | 7.7 |
| Weighted-average discount rate: | |
| Operating leases | 3.1% |
| Finance leases | 4.5% |

## 11. Debt

In May 2019, pursuant to certain agreements between the System and the Martin County Health Facilities Authority, the Martin County Health Facilities Authority issued $247.0 million of fixed-rate Hospital Revenue Bonds (Series 2019A Bonds) for the benefit of the System. Proceeds from the sale of the Series 2019A Bonds were used to acquire the ownership interest in Martin Health System and to pay the cost of issuance. Contemporaneously with the issuance of the Series 2019A Bonds, certain outstanding debt totaling $249.4 million previously incurred by Martin Health System was defeased. Also in May 2019, pursuant to certain agreements between the System and the State of Ohio (State) acting by and through the Ohio Higher Educational Facility Commission, the State issued $250.3 million of fixed-rate Hospital Revenue Bonds (Series 2019B Bonds), $89.0 million of adjustable floating-rate Hospital Revenue Bonds (Series 2019C Bonds) and $380.2 million of variable-rate Hospital Revenue Bonds, comprised of separate issues of $119.3 million (Series 2019D Bonds), $130.4 million (Series 2019E Bonds) and $130.4 million (Series 2019F Bonds). Proceeds from the issuance of the Series 2019C Bonds and Series 2019D Bonds have been used to acquire facilities previously leased by the System under operating lease agreements and to pay the cost of issuance. Proceeds from the issuance of the Series 2019B Bonds, Series 2019E Bonds and Series 2019F Bonds have been or will be used to finance certain capital expenditures of the System and to pay the cost of issuance.

In August 2018, the System through a UK subsidiary entered into a private placement agreement to issue Guaranteed Senior Notes (2018 Sterling Notes) totaling £665 million. The subsidiary received proceeds of £300 million, £100 million and £265 million in August 2018, November 2018 and August 2019, respectively. The 2018 Sterling Notes are guaranteed by the Cleveland Clinic obligated group and another UK subsidiary, mature at various dates from 2048 through 2068 and bear interest at an average fixed rate of 2.99%. The proceeds of the 2018 Sterling Notes repaid a $375.0 million term loan used to acquire a long-term leasehold interest in a building in London, England and have been or will be used to partially fund the construction and conversion of the building into a healthcare facility.

## 12. Assets Held for Sale

In June 2019, the System decided to sell an administrative campus totaling approximately 830,000 square feet. The property is currently being marketed and is expected to be sold within one year. Accordingly, the System reclassified the property from held and used to assets held for sale. The System recorded a loss of $11.6 million, which is reported in depreciation and amortization in the consolidated statements of operations and changes in net assets, to reduce the value of the building to estimated fair value less costs to sell.

## 13. Subsequent Events

The System evaluated events and transactions occurring subsequent to June 30, 2019 through August 29, 2019, the date the consolidated financial statements were issued. During this period, there were no subsequent events requiring recognition in the consolidated financial statements, and there were no nonrecognized subsequent events requiring disclosure.

## Unaudited Consolidating Balance Sheets

*($ in thousands)*

| | June 30, 2019 | | | | December 31, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated |
| **Assets** | | | | | | | | |
| Current assets: | | | | | | | | |
| Cash and cash equivalents | $ 318,512 | $ 191,604 | $ - | $ 510,116 | $ 279,847 | $ 164,916 | $ - | $ 444,763 |
| Patient receivables, net | 1,106,352 | 203,204 | (33,227) | 1,276,329 | 1,008,777 | 150,582 | (36,441) | 1,122,918 |
| Due from affiliates | 5,600 | 42,014 | (47,614) | - | 5,053 | 20 | (5,073) | - |
| Investments for current use | - | 53,841 | - | 53,841 | - | 53,841 | - | 53,841 |
| Other current assets | 414,903 | 124,782 | (4,428) | 535,257 | 359,623 | 67,392 | (550) | 426,465 |
| Total current assets | 1,845,367 | 615,445 | (85,269) | 2,375,543 | 1,653,300 | 436,751 | (42,064) | 2,047,987 |
| Investments: | | | | | | | | |
| Long-term investments | 7,722,985 | 549,312 | - | 8,272,297 | 6,959,237 | 574,431 | - | 7,533,668 |
| Funds held by trustees | 232,246 | 110 | - | 232,356 | 49,353 | 24 | - | 49,377 |
| Assets held for self-insurance | - | 156,612 | - | 156,612 | - | 106,966 | - | 106,966 |
| Donor restricted assets | 749,120 | 58,999 | - | 808,119 | 715,268 | 29,583 | - | 744,851 |
| | 8,704,351 | 765,033 | - | 9,469,384 | 7,723,858 | 711,004 | - | 8,434,862 |
| Property, plant, and equipment, net | 4,683,858 | 1,097,393 | - | 5,781,251 | 4,144,790 | 927,674 | - | 5,072,464 |
| Other assets: | | | | | | | | |
| Pledges receivable, net | 146,216 | 8,437 | - | 154,653 | 150,876 | 1,572 | - | 152,448 |
| Trusts and beneficial interests in foundations | 68,132 | 42,824 | - | 110,956 | 67,279 | 20,327 | - | 87,606 |
| Other noncurrent assets | 724,878 | 237,172 | (231,478) | 730,572 | 546,032 | 63,367 | (197,637) | 411,762 |
| | 939,226 | 288,433 | (231,478) | 996,181 | 764,187 | 85,266 | (197,637) | 651,816 |
| Total assets | $ 16,172,802 | $ 2,766,304 | $ (316,747) | $ 18,622,359 | $ 14,286,135 | $ 2,160,695 | $ (239,701) | $ 16,207,129 |

| | June 30, 2019 | | | | December 31, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated |
| **Liabilities and net assets** | | | | | | | | |
| Current liabilities: | | | | | | | | |
| Accounts payable | $ 368,146 | $ 77,816 | $ (116) | $ 445,846 | $ 448,095 | $ 79,693 | $ (116) | $ 527,672 |
| Compensation and amounts withheld from payroll | 403,648 | 46,608 | - | 450,256 | 329,434 | 29,908 | - | 359,342 |
| Current portion of long-term debt | 88,675 | 6,374 | (72) | 94,977 | 185,676 | 5,746 | (72) | 191,350 |
| Variable rate debt classified as current | 474,834 | 56,752 | - | 531,586 | 351,024 | 56,752 | - | 407,776 |
| Due to affiliates | - | 5,600 | (5,600) | - | 20 | 5,053 | (5,073) | - |
| Other current liabilities | 430,720 | 131,401 | (37,522) | 524,599 | 411,584 | 121,009 | (39,140) | 493,453 |
| Total current liabilities | 1,766,023 | 324,551 | (43,310) | 2,047,264 | 1,725,833 | 298,161 | (44,401) | 1,979,593 |
| Long-term debt | 3,801,895 | 756,115 | (226,617) | 4,331,393 | 3,028,825 | 723,115 | (193,029) | 3,558,911 |
| Other liabilities: | | | | | | | | |
| Professional and general insurance liability reserves | 65,900 | 131,186 | (5,904) | 191,182 | 55,556 | 85,626 | - | 141,182 |
| Accrued retirement benefits | 453,155 | 54,063 | - | 507,218 | 420,436 | 45,091 | - | 465,527 |
| Other noncurrent liabilities | 535,908 | 231,488 | (38,796) | 728,600 | 505,891 | 36,289 | (151) | 542,029 |
| | 1,054,963 | 416,737 | (44,700) | 1,427,000 | 981,883 | 167,006 | (151) | 1,148,738 |
| Total liabilities | 6,622,881 | 1,497,403 | (314,627) | 7,805,657 | 5,736,541 | 1,188,282 | (237,581) | 6,687,242 |
| Net assets: | | | | | | | | |
| Without donor restrictions | 8,497,015 | 1,154,470 | (2,120) | 9,649,365 | 7,547,813 | 919,775 | (2,120) | 8,465,468 |
| With donor restrictions | 1,052,906 | 114,431 | - | 1,167,337 | 1,001,781 | 52,638 | - | 1,054,419 |
| Total net assets | 9,549,921 | 1,268,901 | (2,120) | 10,816,702 | 8,549,594 | 972,413 | (2,120) | 9,519,887 |
| Total liabilities and net assets | $ 16,172,802 | $ 2,766,304 | $ (316,747) | $ 18,622,359 | $ 14,286,135 | $ 2,160,695 | $ (239,701) | $ 16,207,129 |

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Martin Memorial Medical Center, a subsidiary of Martin Health System, became a member of the Obligated Group in May 2019. The financial results of Martin Memorial Medical Center are reported in the Obligated Group beginning January 1, 2019, which is the date it joined the System.

## Unaudited Consolidating Statements of Operations and Changes in Net Assets

*($ in thousands)*

## Operations

| | Three Months Ended June 30, 2019 | | | | Three Months Ended June 30, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated |
| **Unrestricted revenues** | | | | | | | | |
| Net patient service revenue | $ 2,120,828 | $ 351,415 | $ (76,729) | $ 2,395,514 | $ 1,813,932 | $ 243,312 | $ (70,038) | $ 1,987,206 |
| Other | 214,536 | 117,633 | (75,206) | 256,963 | 181,284 | 77,834 | (38,082) | 221,036 |
| Total unrestricted revenues | 2,335,364 | 469,048 | (151,935) | 2,652,477 | 1,995,216 | 321,146 | (108,120) | 2,208,242 |
| **Expenses** | | | | | | | | |
| Salaries, wages, and benefits | 1,259,901 | 259,163 | (88,517) | 1,430,547 | 1,132,695 | 173,685 | (80,885) | 1,225,495 |
| Supplies | 218,863 | 38,079 | (205) | 256,737 | 184,286 | 29,794 | (238) | 213,842 |
| Pharmaceuticals | 292,159 | 29,294 | - | 321,453 | 251,899 | 20,445 | - | 272,344 |
| Purchased services and other fees | 128,040 | 32,588 | (7,311) | 153,317 | 124,601 | 22,998 | (5,106) | 142,493 |
| Administrative services | 30,713 | 31,320 | (5,684) | 56,349 | 40,356 | 21,015 | (5,319) | 56,052 |
| Facilities | 75,209 | 19,724 | (663) | 94,270 | 71,105 | 19,072 | (854) | 89,323 |
| Insurance | 20,276 | 54,086 | (49,530) | 24,832 | 19,834 | 18,306 | (15,693) | 22,447 |
| | 2,025,161 | 464,254 | (151,910) | 2,337,505 | 1,824,776 | 305,315 | (108,095) | 2,021,996 |
| Operating income before interest, depreciation, and amortization expenses | 310,203 | 4,794 | (25) | 314,972 | 170,440 | 15,831 | (25) | 186,246 |
| Interest | 33,015 | 6,439 | - | 39,454 | 29,937 | 4,552 | - | 34,489 |
| Depreciation and amortization | 139,545 | 19,810 | (25) | 159,330 | 109,114 | 16,613 | (25) | 125,702 |
| Operating income (loss) before special charges | 137,643 | (21,455) | - | 116,188 | 31,389 | (5,334) | - | 26,055 |
| Special charges | - | - | - | - | - | 954 | - | 954 |
| Operating income (loss) | 137,643 | (21,455) | - | 116,188 | 31,389 | (6,288) | - | 25,101 |
| **Nonoperating gains and losses** | | | | | | | | |
| Investment return | 168,048 | 13,644 | - | 181,692 | (363) | (468) | - | (831) |
| Derivative (losses) income | (33,171) | (648) | - | (33,819) | 5,986 | (295) | - | 5,691 |
| Other, net | (57,370) | 19,820 | - | (37,550) | 1,597 | 49,153 | - | 50,750 |
| Net nonoperating gains and losses | 77,507 | 32,816 | - | 110,323 | 7,220 | 48,390 | - | 55,610 |
| Excess of revenues over expenses | 215,150 | 11,361 | - | 226,511 | 38,609 | 42,102 | - | 80,711 |

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Martin Memorial Medical Center, a subsidiary of Martin Health System, became a member of the Obligated Group in May 2019. The financial results of Martin Memorial Medical Center are reported in the Obligated Group beginning January 1, 2019, which is the date it joined the System.

## Unaudited Consolidating Statements of Operations and Changes in Net Assets (continued)

*($ in thousands)*

### Changes in Net Assets

| | Three Months Ended June 30, 2019 | | | | Three Months Ended June 30, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated |
| **Changes in net assets without donor restrictions:** | | | | | | | | |
| Excess of revenues over expenses | $ 215,150 | $ 11,361 | $ - | $ 226,511 | $ 38,609 | $ 42,102 | $ - | $ 80,711 |
| Donated capital | - | - | - | - | 460 | - | - | 460 |
| Net assets released from restriction for capital purposes | 38,506 | (2,555) | - | 35,951 | 225 | 244 | - | 469 |
| Retirement benefits adjustment | (3,563) | (58) | - | (3,621) | (659) | (58) | - | (717) |
| Foreign currency translation | - | 373 | - | 373 | - | (22,846) | - | (22,846) |
| Other | (12,907) | 12,757 | - | (150) | (1,078) | 199 | - | (879) |
| Increase in net assets without donor restrictions | 237,186 | 21,878 | - | 259,064 | 37,557 | 19,641 | - | 57,198 |
| **Changes in net assets with donor restrictions:** | | | | | | | | |
| Gifts and bequests | 16,288 | 8,027 | - | 24,315 | 20,125 | 1,088 | - | 21,213 |
| Net investment income | 15,485 | 780 | - | 16,265 | (221) | 222 | - | 1 |
| Net assets released from restrictions used for operations included in other unrestricted revenues | (11,010) | (961) | - | (11,971) | (9,078) | (863) | - | (9,941) |
| Net assets released from restriction for capital purposes | (38,506) | 2,555 | - | (35,951) | (225) | (244) | - | (469) |
| Change in interests in foundations | 324 | - | - | 324 | (54) | - | - | (54) |
| Change in value of perpetual trusts | (184) | 1,109 | - | 925 | 200 | 68 | - | 268 |
| Member substitution contribution | (1,250) | - | - | (1,250) | - | 13,180 | - | 13,180 |
| Other | (2,090) | 2,186 | - | 96 | 83 | - | - | 83 |
| (Decrease) increase in net assets with donor restrictions | (20,943) | 13,696 | - | (7,247) | 10,830 | 13,451 | - | 24,281 |
| Increase in net assets | 216,243 | 35,574 | - | 251,817 | 48,387 | 33,092 | - | 81,479 |
| Net assets at beginning of year | 9,333,678 | 1,233,327 | (2,120) | 10,564,885 | 8,469,788 | 1,007,169 | (2,120) | 9,474,837 |
| Net assets at end of period | $ 9,549,921 | $ 1,268,901 | $ (2,120) | $ 10,816,702 | $ 8,518,175 | $ 1,040,261 | $ (2,120) | $ 9,556,316 |

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Martin Memorial Medical Center, a subsidiary of Martin Health System, became a member of the Obligated Group in May 2019. The financial results of Martin Memorial Medical Center are reported in the Obligated Group beginning January 1, 2019, which is the date it joined the System.

## Unaudited Consolidating Statements of Operations and Changes in Net Assets (continued)

*($ in thousands)*

## Operations

| | Six Months Ended June 30, 2019 | | | | Six Months Ended June 30, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated |
| **Unrestricted revenues** | | | | | | | | |
| Net patient service revenue | $ 4,122,916 | $ 706,399 | $ (150,916) | $ 4,678,399 | $ 3,577,625 | $ 457,322 | $ (137,967) | $ 3,896,980 |
| Other | 410,197 | 200,421 | (114,201) | 496,417 | 365,562 | 143,252 | (75,101) | 433,713 |
| Total unrestricted revenues | 4,533,113 | 906,820 | (265,117) | 5,174,816 | 3,943,187 | 600,574 | (213,068) | 4,330,693 |
| **Expenses** | | | | | | | | |
| Salaries, wages, and benefits | 2,503,036 | 511,157 | (172,489) | 2,841,704 | 2,245,196 | 322,558 | (159,039) | 2,408,715 |
| Supplies | 427,185 | 79,051 | (279) | 505,957 | 366,159 | 51,282 | (400) | 417,041 |
| Pharmaceuticals | 566,516 | 56,836 | - | 623,352 | 485,929 | 40,640 | - | 526,569 |
| Purchased services and other fees | 267,211 | 65,415 | (14,694) | 317,932 | 234,076 | 46,669 | (9,992) | 270,753 |
| Administrative services | 60,104 | 56,581 | (11,112) | 105,573 | 70,113 | 36,508 | (10,592) | 96,029 |
| Facilities | 148,675 | 42,657 | (1,293) | 190,039 | 139,478 | 36,684 | (1,609) | 174,553 |
| Insurance | 41,033 | 74,233 | (65,200) | 50,066 | 37,115 | 36,592 | (31,386) | 42,321 |
| | 4,013,760 | 885,930 | (265,067) | 4,634,623 | 3,578,066 | 570,933 | (213,018) | 3,935,981 |
| Operating income before interest, depreciation, and amortization expenses | 519,353 | 20,890 | (50) | 540,193 | 365,121 | 29,641 | (50) | 394,712 |
| Interest | 66,150 | 13,055 | - | 79,205 | 59,308 | 8,182 | - | 67,490 |
| Depreciation and amortization | 268,219 | 40,429 | (50) | 308,598 | 220,373 | 32,434 | (50) | 252,757 |
| Operating income (loss) before special charges | 184,984 | (32,594) | - | 152,390 | 85,440 | (10,975) | - | 74,465 |
| Special charges | - | - | - | - | - | 1,788 | - | 1,788 |
| Operating income (loss) | 184,984 | (32,594) | - | 152,390 | 85,440 | (12,763) | - | 72,677 |
| **Nonoperating gains and losses** | | | | | | | | |
| Investment return | 505,291 | 48,041 | - | 553,332 | 33,836 | 2,437 | - | 36,273 |
| Derivative (losses) income | (41,198) | (1,108) | - | (42,306) | 21,926 | (819) | - | 21,107 |
| Other, net | 275,173 | 207,298 | - | 482,471 | 3,191 | 53,935 | - | 57,126 |
| Net nonoperating gains and losses | 739,266 | 254,231 | - | 993,497 | 58,953 | 55,553 | - | 114,506 |
| Excess of revenues over expenses | 924,250 | 221,637 | - | 1,145,887 | 144,393 | 42,790 | - | 187,183 |

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Martin Memorial Medical Center, a subsidiary of Martin Health System, became a member of the Obligated Group in May 2019. The financial results of Martin Memorial Medical Center are reported in the Obligated Group beginning January 1, 2019, which is the date it joined the System.

## Unaudited Consolidating Statements of Operations and Changes in Net Assets (continued)

*($ in thousands)*

### Change in Net Assets

| | Six Months Ended June 30, 2019 | | | | Six Months Ended June 30, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated |
| **Changes in net assets without donor restrictions:** | | | | | | | | |
| Excess of revenues over expenses | $ 924,250 | $ 221,637 | $ - | $ 1,145,887 | $ 144,393 | $ 42,790 | $ - | $ 187,183 |
| Donated capital | - | - | - | - | 460 | - | - | 460 |
| Net assets released from restriction for capital purposes | 41,683 | (2,085) | - | 39,598 | 649 | 417 | - | 1,066 |
| Retirement benefits adjustment | (2,183) | (115) | - | (2,298) | (1,317) | (115) | - | (1,432) |
| Foreign currency translation | - | 830 | - | 830 | - | (9,846) | - | (9,846) |
| Other | (14,548) | 14,428 | - | (120) | (1,377) | 548 | - | (829) |
| Increase in net assets without donor restrictions | 949,202 | 234,695 | - | 1,183,897 | 142,808 | 33,794 | - | 176,602 |
| **Changes in net assets with donor restrictions:** | | | | | | | | |
| Gifts and bequests | 42,371 | 17,414 | - | 59,785 | 45,274 | 1,148 | - | 46,422 |
| Net investment income | 39,790 | 2,483 | - | 42,273 | (486) | 687 | - | 201 |
| Net assets released from restrictions used for operations included in other unrestricted revenues | (19,483) | (1,576) | - | (21,059) | (21,802) | (1,590) | - | (23,392) |
| Net assets released from restriction for capital purposes | (41,683) | 2,085 | - | (39,598) | (649) | (417) | - | (1,066) |
| Change in interests in foundations | 1,332 | - | - | 1,332 | (54) | - | - | (54) |
| Change in value of perpetual trusts | (608) | 951 | - | 343 | 683 | 215 | - | 898 |
| Member substitution contribution | 31,488 | 38,250 | - | 69,738 | - | 13,180 | - | 13,180 |
| Other | (2,082) | 2,186 | - | 104 | 59 | 13 | - | 72 |
| Increase in net assets with donor restrictions | 51,125 | 61,793 | - | 112,918 | 23,025 | 13,236 | - | 36,261 |
| Increase in net assets | 1,000,327 | 296,488 | - | 1,296,815 | 165,833 | 47,030 | - | 212,863 |
| Net assets at beginning of year | 8,549,594 | 972,413 | (2,120) | 9,519,887 | 8,352,342 | 993,231 | (2,120) | 9,343,453 |
| Net assets at end of period | $ 9,549,921 | $ 1,268,901 | $ (2,120) | $ 10,816,702 | $ 8,518,175 | $ 1,040,261 | $ (2,120) | $ 9,556,316 |

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Martin Memorial Medical Center, a subsidiary of Martin Health System, became a member of the Obligated Group in May 2019. The financial results of Martin Memorial Medical Center are reported in the Obligated Group beginning January 1, 2019, which is the date it joined the System.

## Unaudited Consolidating Statements of Cash Flows

*($ in thousands)*

| | Six Months Ended June 30, 2019 | | | | Six Months Ended June 30, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated | Obligated Group | Non-Obligated Group | Consolidating Adjustments & Eliminations | Consolidated |
| **Operating activities and net nonoperating gains and losses** | | | | | | | | |
| Increase in total net assets | $ 1,000,327 | $ 296,488 | $ - | $ 1,296,815 | $ 165,833 | $ 47,030 | $ - | $ 212,863 |
| Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities and net nonoperating gains and losses: | | | | | | | | |
| Loss on extinguishment of debt | 17,263 | - | - | 17,263 | - | - | - | - |
| Retirement benefits adjustment | 2,183 | 115 | - | 2,298 | 1,317 | 115 | - | 1,432 |
| Net realized and unrealized (gains) losses on investments | (518,377) | (45,252) | - | (563,629) | (11,438) | 158 | - | (11,280) |
| Depreciation and amortization | 268,219 | 40,429 | (50) | 308,598 | 220,373 | 34,029 | (50) | 254,352 |
| Foreign currency translation (gain) loss | - | (830) | - | (830) | - | 9,846 | - | 9,846 |
| Donated capital | - | - | - | - | (460) | - | - | (460) |
| Restricted gifts, bequests, investment income, and other | (82,885) | (20,848) | - | (103,733) | (45,417) | (2,050) | - | (47,467) |
| Transfers to (from) affiliates | 14,528 | (14,528) | - | - | 556 | (556) | - | - |
| Accreted interest and amortization of bond premiums | (2,732) | 114 | - | (2,618) | (3,061) | 6 | - | (3,055) |
| Net loss (gain) in value of derivatives | 34,742 | (5) | - | 34,737 | (27,083) | (2,575) | - | (29,658) |
| Member substitution | (323,338) | (248,127) | - | (571,465) | - | (65,442) | - | (65,442) |
| Changes in operating assets and liabilities: | | | | | | | | |
| Patient receivables | (38,256) | (5,427) | (3,214) | (46,897) | (81,870) | 10,880 | (4,599) | (75,589) |
| Other current assets | (7,492) | (77,871) | 46,419 | (38,944) | 22,912 | (34,354) | (8,377) | (19,819) |
| Other noncurrent assets | (131,712) | (150,814) | 33,891 | (248,635) | (10,653) | (1,133) | 45,362 | 33,576 |
| Accounts payable and other current liabilities | (17,990) | (4,573) | 1,091 | (21,472) | 11,604 | (53,535) | 45,847 | 3,916 |
| Other liabilities | (31,718) | 208,388 | (44,549) | 132,121 | (6,314) | 23,459 | (32,886) | (15,741) |
| Net cash provided by (used in) operating activities and net nonoperating gains and losses | 182,762 | (22,741) | 33,588 | 193,609 | 236,299 | (34,122) | 45,297 | 247,474 |
| **Financing activities** | | | | | | | | |
| Proceeds from long-term borrowings | 998,906 | 33,588 | (33,588) | 998,906 | 45,000 | 45,297 | (45,297) | 45,000 |
| Payments for redemption of long-term debt | (271,009) | - | - | (271,009) | - | - | - | - |
| Principal payments on long-term debt | (248,512) | (35,994) | - | (284,506) | (70,349) | (47,024) | - | (117,373) |
| Debt issuance costs | (6,559) | - | - | (6,559) | - | - | - | - |
| Change in pledges receivable, trusts and interests in foundations | 5,918 | (3,295) | - | 2,623 | (6,296) | (237) | - | (6,533) |
| Restricted gifts, bequests, investment income, and other | 82,885 | 20,848 | - | 103,733 | 45,417 | 2,050 | - | 47,467 |
| Net cash provided by financing activities | 561,629 | 15,147 | (33,588) | 543,188 | 13,772 | 86 | (45,297) | (31,439) |
| **Investing activities** | | | | | | | | |
| Expenditures for property, plant and equipment | (467,506) | (59,498) | - | (527,004) | (315,618) | (41,013) | - | (356,631) |
| Proceeds from sale of property, plant and equipment | 59,749 | - | | 59,749 | - | - | | - |
| Member substitution cash contributions | (1,260) | 17,662 | - | 16,402 | - | 1,515 | - | 1,515 |
| Net change in cash equivalents reported in long-term investments | (320,806) | 48,597 | - | (272,209) | 214,384 | 38,134 | - | 252,518 |
| Purchases of investments | (2,889,553) | (206,438) | - | (3,095,991) | (1,156,881) | (99,111) | - | (1,255,992) |
| Sales of investments | 2,928,178 | 218,261 | - | 3,146,439 | 1,057,398 | 105,881 | - | 1,163,279 |
| Transfers (to) from affiliates | (14,528) | 14,528 | - | - | (556) | 556 | - | - |
| Net cash (used in) provided by investing activities | (705,726) | 33,112 | - | (672,614) | (201,273) | 5,962 | - | (195,311) |
| Effect of exchange rate changes on cash | - | 1,170 | | 1,170 | - | (2,134) | | (2,134) |
| Increase (decrease) in cash and cash equivalents | 38,665 | 26,688 | - | 65,353 | 48,798 | (30,208) | - | 18,590 |
| Cash and cash equivalents at beginning of year | 279,847 | 164,916 | - | 444,763 | 27,644 | 213,583 | - | 241,227 |
| Cash and cash equivalents at end of period | $ 318,512 | $ 191,604 | $ - | $ 510,116 | $ 76,442 | $ 183,375 | $ - | $ 259,817 |

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Martin Memorial Medical Center, a subsidiary of Martin Health System, became a member of the Obligated Group in May 2019. The financial results of Martin Memorial Medical Center are reported in the Obligated Group beginning January 1, 2019, which is the date it joined the System.

## Utilization

The following table provides selected utilization statistics for the Cleveland Clinic Health System:

| | Year Ended December 31 | | | YTD June 30 | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2018 | 2019 |
| Total Staffed Beds[(1)] | 3,931 | 3,847 | 4,143 | 4,038 | 4,894 |
| Percent Occupancy[(1)] | 69.3% | 70.6% | 68.8% | 71.1% | 68.6% |
| Inpatient Admissions[(1)] | | | | | |
| Acute | 167,447 | 173,880 | 174,653 | 86,406 | 111,275 |
| Post-acute | 12,424 | 11,526 | 10,635 | 5,441 | 5,719 |
| Total | 179,871 | 185,406 | 185,288 | 91,847 | 116,994 |
| Patient Days[(1)] | | | | | |
| Acute | 857,990 | 890,353 | 901,801 | 450,908 | 547,504 |
| Post-acute | 103,979 | 92,449 | 79,737 | 39,876 | 42,287 |
| Total | 961,969 | 982,802 | 981,538 | 490,784 | 589,791 |
| Average Length of Stay | | | | | |
| Acute | 5.13 | 5.10 | 5.18 | 5.24 | 4.93 |
| Post-acute | 8.39 | 8.03 | 7.52 | 7.41 | 7.43 |
| Surgical Facility Cases | | | | | |
| Inpatient | 60,671 | 62,375 | 62,655 | 31,188 | 36,574 |
| Outpatient | 151,300 | 149,103 | 157,697 | 76,035 | 90,236 |
| Total | 211,971 | 211,478 | 220,352 | 107,223 | 126,810 |
| Emergency Department Visits | 652,073 | 644,185 | 675,657 | 330,935 | 439,058 |
| Outpatient Observations | 58,384 | 59,868 | 62,934 | 30,606 | 43,434 |
| Outpatient Evaluation and Management Visits | 4,235,729 | 4,407,973 | 4,632,296 | 2,539,070 | 3,167,239 |
| Acute Medicare Case Mix Index - Health System | 1.92 | 1.90 | 1.96 | 1.95 | 1.98 |
| Acute Medicare Case Mix Index - Cleveland Clinic | 2.53 | 2.59 | 2.71 | 2.69 | 2.72 |
| Total Acute Patient Case Mix Index - Health System | 1.82 | 1.84 | 1.89 | 1.89 | 1.89 |
| Total Acute Patient Case Mix Index - Cleveland Clinic | 2.45 | 2.52 | 2.63 | 2.62 | 2.63 |

(1) Acute and post-acute, including rehabilitative and psychiatric services within post-acute, but excluding newborns and bassinets.

Utilization statistics for Union Hospital are included beginning April 1, 2018, which is the date Union Hospital joined the System.

Utilization statistics for Martin Health System and Indian River Hospital are included beginning January 1, 2019, which is the date both entities joined the System.

## Utilization (continued)

The following table provides selected utilization statistics for the Obligated Group:

| | Year Ended December 31 | | | YTD June 30 | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2018 | 2019 |
| Total Staffed Beds[(1)] | 3,412 | 3,352 | 3,477 | 3,404 | 3,981 |
| Percent Occupancy[(1)] | 69.6% | 71.8% | 70.9% | 72.7% | 70.5% |
| Inpatient Admissions[(1)] | | | | | |
| Acute | 144,038 | 150,300 | 149,047 | 74,026 | 105,035 |
| Post-acute | 9,471 | 9,500 | 8,452 | 4,369 | 3,647 |
| Total | 153,509 | 159,800 | 157,499 | 78,395 | 108,682 |
| Patient Days[(1)] | | | | | |
| Acute | 755,138 | 778,333 | 785,433 | 395,520 | 525,289 |
| Post-acute | 76,113 | 77,908 | 62,644 | 32,054 | 27,120 |
| Total | 831,251 | 856,241 | 848,077 | 427,574 | 552,409 |
| Surgical Facility Cases | | | | | |
| Inpatient | 54,072 | 56,041 | 56,144 | 28,044 | 34,419 |
| Outpatient | 135,918 | 133,740 | 138,161 | 67,285 | 81,025 |
| Total | 189,990 | 189,781 | 194,305 | 95,329 | 115,444 |
| Emergency Department Visits | 535,478 | 530,384 | 531,822 | 264,811 | 390,775 |
| Outpatient Observations | 50,671 | 52,485 | 53,112 | 26,264 | 39,578 |
| Outpatient Evaluation and Management Visits | 4,232,729 | 4,404,070 | 4,628,353 | 2,288,011 | 3,049,078 |
| Acute Medicare Case Mix Index | 1.97 | 1.95 | 2.01 | 1.99 | 2.02 |
| Total Acute Patient Case Mix Index | 1.87 | 1.89 | 1.95 | 1.95 | 1.95 |

(1) Acute and post-acute, including rehabilitative and psychiatric services within post-acute, but excluding newborns and bassinets.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

## Payor Mix

The following table shows payor mix as a percentage of gross patient service revenue for the health system and obligated group as a whole:

| | Year Ended December 31 | | | YTD June 30 | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2018 | 2019 |
| **Payor** | | | | | |
| Managed Care and Commercial | 39% | 38% | 37% | 37% | 34% |
| Medicare | 44% | 46% | 47% | 47% | 50% |
| Medicaid | 14% | 14% | 14% | 14% | 13% |
| Self-Pay & Other | 3% | 2% | 2% | 2% | 3% |
| Total | 100% | 100% | 100% | 100% | 100% |

**OBLIGATED GROUP**
**Based on Gross Patient Service Revenue**

| | Year Ended December 31 | | | YTD June 30 | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2018 | 2019 |
| **Payor** | | | | | |
| Managed Care and Commercial | 40% | 39% | 38% | 38% | 35% |
| Medicare | 44% | 46% | 47% | 47% | 49% |
| Medicaid | 13% | 13% | 13% | 13% | 13% |
| Self-Pay & Other | 3% | 2% | 2% | 2% | 3% |
| Total | 100% | 100% | 100% | 100% | 100% |

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Payor mix for Union Hospital are included beginning April 1, 2018, which is the date Union Hospital joined the System.

Payor mix for Martin Health System and Indian River Hospital are included beginning January 1, 2019, which is the date both entities joined the System.

## Research Support

*($ in thousands)*

The Clinic funds the annual cost of research from external sources, such as federal grants and contracts and contributions restricted for research, and internal sources, such as contributions, endowment earnings and revenue from operations. The following table summarizes the sources of research support for the Clinic:

| | Year Ended December 31 | | | YTD June 30 | |
|---|---|---|---|---|---|
| | **2016** | **2017** | **2018** | **2018** | **2019** |
| External Grants Earned | | | | | |
| Federal Sources | $108,253 | $114,942 | $117,786 | $58,796 | $62,419 |
| Non-Federal Sources | 87,883 | 92,564 | 105,093 | 51,163 | 49,352 |
| Total | 196,136 | 207,506 | 222,879 | 109,959 | 111,771 |
| Internal Support | 59,326 | 59,873 | 63,327 | 29,970 | 35,853 |
| Total Sources of Support | $255,462 | $267,379 | $286,206 | $139,929 | $147,624 |

## Key Ratios

The following table provides selected key ratios for the System as a whole:

| | Year Ended December 31 | | | YTD June 30 | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2018 | 2019 |
| Liquidity ratios | | | | | |
| Days of cash on hand | 349 | 383 | 355 | 371 | 345 |
| Days of revenue in accounts receivable | 51 | 49 | 49 | 51 | 48 |
| Coverage ratios | | | | | |
| Cash to debt (%) | 172.7 | 197.9 | 191.9 | 200.7 | 177.1 |
| Maximum annual debt service coverage (x) | 3.8 | 5.3 | 5.1 | 5.0 | 5.2 |
| Interest expense coverage (x) | 7.5 | 9.1 | 9.2 | 9.1 | 8.7 |
| Debt to cash flow (x) | 4.6 | 3.5 | 3.7 | 3.6 | 4.3 |
| Leverage ratio | | | | | |
| Debt to capitalization (%) | 36.4 | 32.5 | 32.9 | 32.0 | 33.9 |
| Profitability ratios | | | | | |
| Operating margin (%) | 3.0 | 3.9 | 3.0 | 1.7 | 2.9 |
| Operating cash flow margin (%) | 11.0 | 11.5 | 10.1 | 9.1 | 10.4 |
| Excess margin (%) | 6.2 | 12.5 | 1.2 | 4.2 | 18.6 |
| Return on assets (%) | 3.6 | 7.3 | 0.6 | 2.3 | 12.3 |

*NOTE:*
*Coverage and liquidity ratios are calculated using a 12-month rolling income statement.*

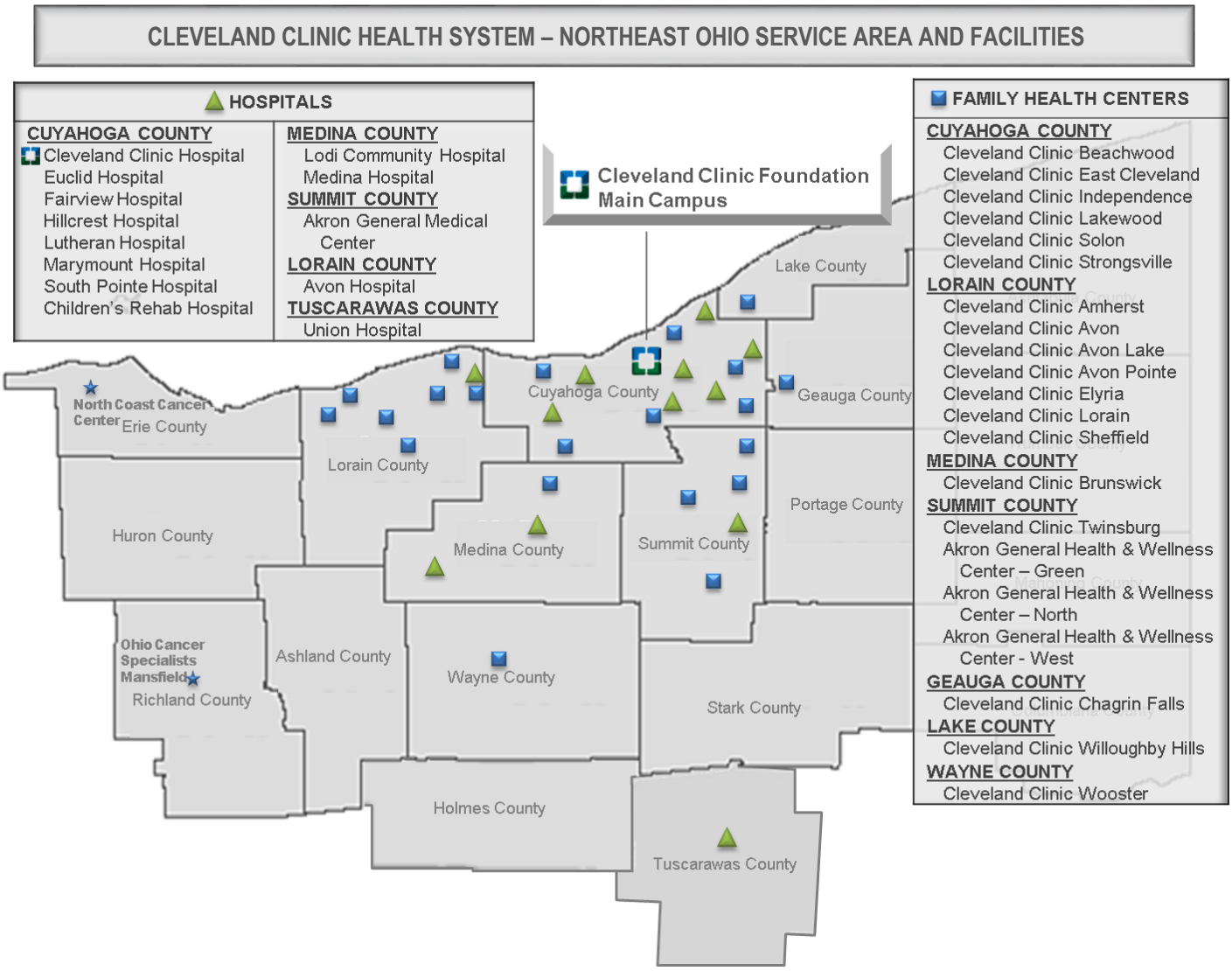
## OVERVIEW

The Cleveland Clinic Health System (System) is a world-renowned provider of healthcare services that attracted patients from across the United States and from 132 other countries in 2018. The System operates 18 hospitals with approximately 4,900 staffed beds and is the leading provider of healthcare services in Northeast Ohio. Thirteen of the hospitals are operated in the Northeast Ohio area, anchored by The Cleveland Clinic Foundation (Clinic). The System operates 21 outpatient family health centers, 11 ambulatory surgery centers, as well as numerous physician offices, which are located throughout Northeast Ohio, and specialized cancer centers in Sandusky and Mansfield, Ohio. In Florida, the System operates five hospitals and a clinic located throughout Southeast Florida, outpatient family health centers in West Palm Beach and St. Lucie, an outpatient family health and ambulatory surgery center in Coral Springs and numerous physician offices located throughout Southeast Florida. In addition, the System operates a health and wellness center and a sports medicine clinic in Toronto, Canada and a specialized neurological clinical center in Las Vegas, Nevada. Pursuant to agreements, the System also provides management services for Ashtabula County Medical Center, located in Ashtabula, Ohio, with approximately 180 staffed beds, and Cleveland Clinic Abu Dhabi, a multispecialty hospital offering critical and acute care services that is part of Mubadala Development Company's network of healthcare facilities located in Abu Dhabi, United Arab Emirates with approximately 364 staffed beds.

In January 2019, the Clinic through a subsidiary became the sole member of Martin Memorial Health Systems, Inc. (Martin Health System) and Indian River Memorial Hospital, Inc. (Indian River Hospital) through non-cash business combination transactions. Martin Health System and Indian River Hospital operate healthcare facilities in Southeast Florida. For a description of Martin Health System and Indian River Hospital, refer to "FLORIDA GROWTH."


**Strongsville Family Health Center**
**Strongsville, Ohio**

The location of the System's hospitals, its family health centers and its specialized cancer centers in the Northeast Ohio area are identified on the following map:




Cleveland Clinic

Every life deserves world class care.

The location of the System's hospitals and family health centers in the Southeast Florida area are identified on the following map:

**CLEVELAND CLINIC HEALTH SYSTEM – SOUTHEAST FLORIDA FACILITIES**

The following table sets forth the hospitals operated by the obligated issuers and their affiliates, together with each hospital's staffed bed count as of June 30, 2019:

| | Staffed Beds |
|---|---|
| **OBLIGATED** | |
| Cleveland Clinic | 1,294 |
| Avon Hospital | 126 |
| Euclid Hospital | 165 |
| Fairview Hospital | 460 |
| Hillcrest Hospital | 440 |
| Lutheran Hospital | 194 |
| Martin Hospital North | 247 |
| Martin Hospital South | 97 |
| Marymount Hospital | 255 |
| Medina Hospital | 148 |
| South Pointe Hospital | 172 |
| Tradition Hospital | 177 |
| Weston Hospital | 206 |
| | 3,981 |
| **NON-OBLIGATED** | |
| Akron General Medical Center | 482 |
| Children's Rehabilitation Hospital | 25 |
| Indian River Hospital | 250 |
| Lodi Hospital | 20 |
| Union Hospital | 136 |
| | 913 |
| **HEALTH SYSTEM** | 4,894 |

## AWARDS & RECOGNITION

The Clinic was ranked as the fourth best hospital in the United States by *U.S. News and World Report* in its 2019-2020 edition of "America's Best Hospitals." For the past 21 years, the Clinic has been ranked among the top five hospitals in the United States. The Clinic's Heart and Vascular Institute, located on the Clinic's main campus, was recognized as the best cardiology and heart surgery program in the United States, an honor the Clinic has received annually for 25 consecutive years. The Clinic was nationally ranked in 15 specialties, including eleven in the top ten nationwide, and is one of just 21 hospitals to earn a place on the *U.S. News'* 2019-2020 Honor Roll. The following table summarizes the Clinic's national rankings by medical specialty:

Cleveland Clinic Children's Hospital located on the Clinic's main campus ranked as one of the top pediatric hospitals in the country. The Children's Hospital earned national recognition in nine out of ten medical specialties ranked by *U.S. News and World Report* in its 2019-2020 edition of "Best Children's Hospitals." The following table summarizes the Clinic's national rankings by pediatric specialty:


The publication also evaluated hospitals by state and metropolitan area with a methodology similar to that used to determine the national rankings. The Clinic was ranked as the best hospital in both the State of Ohio and the Cleveland metropolitan area, which includes the City of Cleveland and its surrounding counties. The report also ranked two additional System hospitals in the top hospitals in the Cleveland metropolitan area and Ohio: Fairview Hospital ranked third in the Cleveland metropolitan area and fourth in Ohio; and Hillcrest Hospital ranked fourth in the Cleveland metropolitan area and fifth in Ohio. Akron General Medical Center, located in Summit County, was ranked first in the Akron metropolitan area and 14th in the State of Ohio. Weston Hospital was ranked first in the Miami-Fort Lauderdale metro area and fifth in the State of Florida, and Indian River ranked 27th in the State of Florida.

In March 2019, the Clinic was named the second best hospital in the world by *Newsweek* in its list of "The 10 Best Hospitals in the World." The rankings were determined by a panel of doctors, medical professionals and administrators across four continents brought together by *Newsweek* and Statista Inc., a global market research and consumer data company. *Newsweek* supports this ranking by citing that the Clinic is among the largest medical providers in the world, performed the world's first total facial transplant, and was the first major medical center to organize with patient-center institutes to combine clinical services around a single disease or organ system.

In 2019, the Clinic was named one of the World's Most Ethical Companies by the Ethisphere Institute for the seventh consecutive year. Ethisphere Institute is a global leader in defining

and advancing the standards of ethical business practices. The award recognizes organizations that promote ethical business standards and practices internally, enable managers and employees to make good choices and shape future industry standards by introducing best practices. Companies were evaluated in five categories: ethics and compliance programs; corporate citizenship and responsibility; culture of ethics; governance; and leadership, innovation and reputation.

The Clinic's main campus, Avon Hospital, and Cleveland Clinic Florida have received the 2019 Healthgrades Outstanding Patient Experience Award. The award recognizes hospitals that provide an overall outstanding patient experience. Healthgrades evaluates patient experience performance by applying a scoring methodology to nine patient experience measures, from a 32-question survey of the hospital's own patients. The methodology uses Hospital Consumer Assessment of Healthcare Providers and Systems (HCAHPS) patient survey data from the Centers for Medicare and Medicaid Services.

In April 2019, Avon Hospital was granted an Advanced Certification for Primary Stroke by the Joint Commission. With the addition of Avon Hospital, the System has eleven certified Primary Stroke Centers.

In February, a multispecialty team at the Clinic performed its first in utero fetal surgery, which was northern Ohio's first surgery of its kind. The surgery was performed to repair a spina bifida birth defect on an approximately 23 week old fetus. The baby was delivered near full term in June.

In June, the Clinic became the first hospital in North America to deliver a baby from a uterus that was transplanted from a deceased donor. This was the second time worldwide this procedure has been performed. The uterus was transplanted in late 2017, and the mother became pregnant in late 2018. The transplant and birth are part of an ongoing clinical trial at the Clinic. Since the start of the clinical trial, the team has completed three successful uterus transplants.

In June, the Clinic announced new research that shows that artificial intelligence (AI) can use medical scans and health records to personalize the dose of radiation therapy used to treat cancer patients. The research team developed an AI framework based on patient computerized tomography (CT) scans and electronic health records. This new AI framework is the first to use medical scans to inform radiation dosage, moving the field forward from using generic dose prescriptions to more individualized treatments. The goal of the research is to deliver radiation therapy to account for differences in individual tumor characteristics and patient-specific factors that may affect treatment success.

The Clinic was recognized by *Becker's Hospital Review* on its national list of the 150 Top Places to Work in Healthcare for 2019. The list highlights hospitals, health systems and healthcare companies that promote diversity within the workforce, employee engagement and professional growth. Becker's Healthcare developed this list based on nominations and editorial research.

The System was also recognized by *The Plain Dealer* newspaper as one of Northeast Ohio's top workplaces for 2019, ranking thirteenth in the category for large local employers. This list is based on employee feedback gathered through an anonymous survey administered by a third-party research partner. This is the System's seventh time on this list.

In March 2019, the Clinic was named the second most innovative hospital in the United States in a

survey of more than 300 healthcare executives and staff conducted by *Reaction Data*. Hospitals were recognized based on survey participant opinions of organizations that were considered a model for innovation, quality care at a sustainable cost and thought leadership on topics related to healthcare transformation.

The Clinic's CEO and President, Tomislav Mihaljevic, M.D., was named the twelfth most influential physician executive in the nation by *Modern Healthcare* in its 2019 list of the fifty most influential physician executives and leaders. The list honors physicians working in the healthcare industry who are recognized by their peers and an expert panel as being influential in terms of demonstrated leadership and impact. Dr. Mihaljevic was recognized for his continued focus on the Clinic's growth both in the U.S. and abroad, for overseeing rapid growth in virtual care, and for focusing on improving life for clinical staff.

## FINANCING DEVELOPMENTS

In May 2019, pursuant to certain agreements between the System and the Martin County Health Facilities Authority, the Martin County Health Facilities Authority issued $247.0 million of fixed-rate Hospital Revenue Bonds (Series 2019A Bonds) for the benefit of the System. Proceeds from the sale of the Series 2019A Bonds were used to acquire the ownership interest in Martin Health System and to pay the cost of issuance. Contemporaneously with the issuance of the Series 2019A Bonds, certain outstanding debt totaling $249.4 million previously incurred by Martin Health System was defeased. Also in May 2019, pursuant to certain agreements between the System and the State of Ohio (State) acting by and through the Ohio Higher Educational Facility Commission, the State issued $250.3 million of fixed-rate Hospital Revenue Bonds (Series 2019B Bonds), $89.0 million of adjustable floating-rate Hospital Revenue Bonds (Series 2019C Bonds) and $380.2 million of variable-rate Hospital Revenue Bonds, comprised of separate issues of $119.3 million (Series 2019D Bonds), $130.4 million (Series 2019E Bonds) and $130.4 million (Series 2019F Bonds). Proceeds from the issuance of the Series 2019C Bonds and Series 2019D Bonds were used to acquire facilities previously leased by the System under operating lease agreements and to pay the cost of issuance. Proceeds from the issuance of the Series 2019B Bonds, Series 2019E Bonds and Series 2019F Bonds have been or will be used to finance certain capital expenditures of the System and to pay the cost of issuance. The long-term rating assigned to the bonds issued in 2019 by Moody's Investors Service (Moody's) and Standard & Poor's (S&P) were Aa2 and AA, respectively.

In April 2019, Moody's affirmed its Aa2 rating on the obligated group's outstanding debt and maintained its stable outlook. Moody's cited various factors to support this rating and outlook, including a national and international clinical reputation, a leading local market position, high degree of integration and centralization, strong liquidity with sustained good operating cashflow margins and exceptional fundraising abilities. In its report, Moody's indicated that these strengths compensate for challenges such as moderately high debt levels, execution risks of multiple strategies that require elevated capital spending, competition in the local market and Florida and constrained revenue in Northeast Ohio due to weak demographic trends.

In April 2019, S&P affirmed its AA rating on the obligated group's outstanding debt and maintained its stable outlook. S&P cited various reasons to support the rating, including a unique

and very strong enterprise profile, continued focus on outpatient services and the utilization of technology to provide healthcare services and a stable leadership team that has executed at a high level on its strategic plans. S&P also noted that the System has a robust research program and one of the largest medical residency programs in the nation. Challenges to the current rating include Northeast Ohio's unfavorable demographic trends, the System's robust capital spending program and a highly competitive service area in Northeast Ohio.

In August 2018, the System through a UK subsidiary entered into a private placement agreement to issue Guaranteed Senior Notes (2018 Sterling Notes) totaling £665 million. The subsidiary received proceeds of £300 million, £100 million and £265 million in August 2018, November 2018 and August 2019, respectively. The 2018 Sterling Notes are guaranteed by the Cleveland Clinic obligated group and another UK subsidiary, mature at various dates from 2048 through 2068 and bear interest at an average fixed rate of 2.99%. The proceeds of the 2018 Sterling Notes repaid a $375.0 million term loan used to acquire a long-term leasehold interest in a building in London, England and have been or will be used to partially fund the construction and conversion of the building into a healthcare facility. The 2018 Sterling Notes were assigned a rating of AA by S&P.

**Cleveland Clinic Twinsburg**
**Twinsburg, Ohio**

## CORPORATE GOVERNANCE

The Board of Directors of the Clinic is responsible for all of its operations and affairs and controls its property. The Board of Directors is also responsible for ensuring that the Clinic is organized, and at all times operated, consistent with its charitable mission and its status as an Ohio nonprofit corporation and tax-exempt charitable organization. The Board of Directors generally meets five times per year, including an annual meeting during which the Clinic's officers are elected and standing committees are appointed. The size of the Board of Directors can range between 15 to 30 Directors (currently there are 28 Directors). The Board of Trustees serves as an advisor to the Board of Directors. The Trustees actively serve on the committees of the Board of Directors. At present, there are 65 active Trustees, nine Professional Staff Trustees and 14 Emeritus Trustees. Directors and Trustees each serve four-year terms and are selected on the basis of their expertise and experience in a variety of areas beneficial to the Clinic. Directors and Trustees are not compensated for their service.

The Board of Directors annually appoints certain committees to perform duties that it delegates to them from time to time, subject to ratification of such action by the Board of Directors. The current committees are as follows:


Members of the Committees are chosen based on the interests and skills of individual Board members and the needs of the particular Committee. Most Committees meet three or four times per year, though a few (such as the Audit Committee) meet five or six times per year.

The System maintains a governance model for the Ohio regional hospitals that provides for regional hospital representation on the Clinic's Board of Directors while also maintaining separate boards of trustees for each hospital. The Ohio regional hospital boards meet quarterly and, among other topics, provide local input on quality and patient safety and community health needs. Each Ohio regional hospital has a president, all of whom report to the President of Regional Hospitals and Family Health Centers.

Concurrently with Martin Health System and Indian River Hospital joining the System, the System established a separate Board of Directors to oversee the Florida hospitals. This Board of Directors has representatives from the Clinic Board of Directors and each of the Florida hospitals. Boards have also been maintained at Martin Health System and Indian River to provide local input on quality and patient safety and community health needs.

## APPOINTMENTS

**Timothy Longville** was appointed Chief Accounting Officer and Controller of the Clinic in March 2019. Mr. Longville most recently served as Executive Director of Corporate Accounting and has over 27 years of financial healthcare experience at the System. He succeeds Michael Harrington, who left the System.

**Semih Sen** was appointed Chief Business Development Officer of the Clinic in July 2019. Mr. Sen was the founding partner of Biolinka Investment Holding and has over 24 years of international experience as an executive in greenfield business development, equity partnerships and project financing in the healthcare industry. In this newly created role, Mr. Sen is responsible for driving transformational healthcare partnerships and alliances that create value for the System. He previously led the development of an integrated healthcare network in the United Arab Emirates as a Director at Mubadala Investment Company's Healthcare Unit, the System's partner for Cleveland Clinic Abu Dhabi.

**Teresa Dews, MD** was appointed President of Euclid Hospital in July 2019. Dr. Dews joined the Clinic in 1993 and most recently served as Chief Medical Officer at Hillcrest Hospital and Vice Chair of Cleveland Clinic Pain Management Department.

## EXPANSION AND IMPROVEMENT PROJECTS

Due to the anticipated long-term growth in the demand for services and the desire to continually upgrade medical facilities, the System is investing in buildings, equipment and technology to better serve its patients.

The System has the following expansion and improvement projects recently completed or currently in progress:

Health Education Campus - In 2013, the Clinic and Case Western Reserve University (CWRU) reached an agreement to build a health education campus on the Clinic's main campus to house the CWRU School of Medicine, which includes the Cleveland Clinic Lerner College of Medicine. The health education campus includes a four-story, 477,000-square-foot medical school facility that serves as home for the seminar, lecture, and

laboratory curriculum taught during the first two years of medical school. Students' clinical training continues to take place at area hospitals. This initiative is aligned with the future plans of the Clinic's main campus and supports the Clinic's mission and strategic direction. The facility also houses the CWRU Frances Payne Bolton School of Nursing and CWRU School of Dental Medicine. The medical school facility was designed to encourage interprofessional education. Construction of the medical school facility broke ground on October 1, 2015 and was completed in April 2019, with students transitioning to the facility between May and August 2019 in a phased process. CWRU and the Clinic shared in the construction costs of approximately $456 million, with a portion of the construction costs expected to be raised through fundraising efforts and donations, and will share in the ongoing operational costs of the facility. A separate three-story, 126,000-square-foot dental clinic was constructed adjacent to the medical school facility at a cost of approximately $66 million. The dental clinic provides a space where students can treat patients under dental faculty supervision. Construction of the dental clinic broke ground in October 2017 and opened in the summer of 2019.

Cleveland Clinic London Hospital – In 2015, the Clinic acquired a long-term leasehold interest in a six-story 198,000-square-foot building in London, England. In January 2017, regulatory approvals were received to convert the building from office space into an approximately 200-bed hospital with eight operating theatres. Construction on the conversion began in February 2017, and the facility is expected to open for patients in early 2021. The System through a UK subsidiary entered into a private placement agreement in August 2018 to repay a term loan that was used to finance the acquisition costs and to fund a portion of the construction and conversion costs of the facility. For a description of the London hospital financing, refer to "FINANCING DEVELOPMENTS."

Neurological Institute Building – In July 2019 the Clinic announced plans to build a new Neurological Institute building and expand the Cole Eye Institute on its main campus to accommodate the expansion of patient care, research and education. The new facility for the Neurological Institute is a proposed 400,000-square-foot building that will centralize all outpatient neurological care on the main campus, bringing together services currently delivered in eight locations. Services are expected to include digitized patient evaluations, imaging, neuro-simulation training, infusion therapy, neurodiagnostics and brain-mapping suites. The facility will also include research space dedicated to investigating new therapies and will serve as the nucleus for neurology-related distance health care and digitized data processing and management. Groundbreaking for the Neurological Institute building is being planned within the next two years. A portion of the construction costs are expected to be raised through fundraising efforts and donations.

Cole Eye Institute Expansion - In July 2019 the Clinic announced plans to expand the Cole Eye Institute on its main campus to accommodate the expansion of patient care, research and education. The expansion of the Cole Eye Institute, which has grown significantly over the last 10 years, includes adding more than 100,000 square feet to the existing building to accommodate growing patient eye care and research needs. The new addition will feature an ophthalmic surgical center with operating rooms and new exam

rooms, a new Center of Excellence in Ophthalmic Imaging, an expanded simulation center for resident and fellow education and training and an ophthalmic research center to promote eye research, as well as consolidation of multiple ophthalmology research labs currently housed at different locations. Groundbreaking for the Cole Eye Institute is planned for next year. A portion of the construction costs are expected to be raised through fundraising efforts and donations.

## PHILANTHROPY CAMPAIGN

The Clinic is currently in the midst of "The Power of Every One" philanthropic campaign. The campaign was publicly launched in 2014 with a goal of raising $2 billion by the Clinic's 100th anniversary in 2021. The campaign will enable the Clinic to transform patient care, promote health, advance research and innovation, train caregivers and revitalize facilities through new construction and renovation of existing buildings. As of June 30, 2019, the Clinic has received pledges, cash and other assets of approximately $1.6 billion toward the goal.

The $2 billion campaign is divided into four categories: promoting health ($800 million), advancing discovery ($700 million), training caregivers ($400 million) and transforming care ($100 million). Promoting health will focus on improving patient experience and supporting construction and renovation projects, renovation of vacated space, new facilities in Florida and other building projects at its Northeast Ohio hospitals and family health centers. Training caregivers will support scholarships, training programs and the construction of the new health education campus in collaboration with CWRU. Advancing discovery will support translational, basic science and clinical research as well as endowed chairs. Transforming care will support the development of new care delivery models, personalized therapies and information technology.

## INNOVATIONS AND VENTURES

Cleveland Clinic Innovations promotes scientific, clinical and administrative creativity throughout the System into products that benefit patients around the world. Specifically, it helps to grow the Clinic's innovative capacity, mentors inventors, licenses technology, secures resources, and establishes spin-off companies and strategic collaborations with corporate partners. Since 2000, Cleveland Clinic Innovations has launched 88 companies, transacted more than 600 technology licenses, filed over 4,100 patent applications with over 1,500 issued patents, and acted on approximately 3,800 new inventions. In 2018, the Clinic executed 44 transactions to provide Clinic inventions to external organizations for development and commercialization in various fields, including orthopedics, telemedicine, cardiovascular, immunology and concussion management.

Cleveland Clinic Ventures operates in tandem with Cleveland Clinic Innovations to turn medical breakthrough inventions into products and companies. The strategy of Cleveland Clinic Ventures is to maximize the success and

sustainability of spin-offs and to raise funds that help get ideas to market through funding strategies and business model development.

Cleveland Clinic Innovations manages the Healthcare Innovations Alliance, a collaborative network of healthcare systems, academic institutions and industry partners from around the nation. Alliance partners utilize the Clinic's comprehensive technology and commercialization experience to turn medical ideas into marketable inventions and commercial ventures. The integration of capabilities between organizations is focused on discovery, development and rapid deployment of new technologies with the goal of improving patient care.

Cleveland Clinic Innovations hosts an annual Medical Innovation Summit in downtown Cleveland for industry leaders, investors and entrepreneurs looking to expand their understanding of the healthcare market and the future of medical innovation. The 2018 Medical Innovation Summit and its affiliated events held in October 2018 hosted approximately 2,000 attendees, who discussed the future of healthcare and the latest opportunities and challenges in the healthcare industry with various keynote addresses from authors and business leaders in healthcare. In addition to the keynotes, other highlights included a panel discussion featuring members of the care team that completed the face transplant at the Clinic in 2017 as well as the unveiling of the Top 10 Medical Innovations for 2019, which highlights the potential for medical breakthroughs in the coming year. The "Top 10" has been led by Cleveland Clinic Innovations since its debut in 2007. Each year, Cleveland Clinic Innovations interviews over 75 Clinic experts to elicit more than 150 nominations, which are presented, debated and ranked in a series by two separate committees of clinical experts that vote on the combined lists to establish the Top 10 Medical Innovations.

The 2019 Medical Innovation Summit, *Caring for Every Life through Innovation,* is scheduled for October 2019. The 2019 Summit will focus on artificial intelligence, new drug discovery, non-traditional participants and personalization in healthcare. The Clinic will also host the 2019 Value-Based Innovation Summit (Best Practices in and Accountable World) and the 2019 Nursing Innovation Summit (Inspiration, Cultivation, Collaboration), which will run concurrently with the 2019 Medical Innovation Summit. Collectively, these summits will bring together clinical, financial and global benefit thought leaders from around the world for a discussion of best practices and solutions in value-based care and other forms of medical innovation.

Cleveland Clinic Innovations operates a 50,000-square-foot Global Cardiovascular Innovation Center (GCIC) on the Clinic's main campus, which is home to its operations, as well as an incubator facility for approximately 30 companies. GCIC has supported the development of over 50 technologies and the creation of over 1,000 new jobs.

## CLINICAL AFFILIATIONS

The Clinic has entered into various affiliations with national and regional partners that are seeking to improve clinical quality, patient care, medical education and research. The goal of clinical affiliations is to provide value-added, high-quality clinical care to patients through the support, expansion and development of Institute-driven integrated care strategies. In addition, the Clinic has partnered

with educational institutions with the goal of improving medical education and research.

In March 2019, the Clinic announced that it would be expanding its affiliation agreement with Akron Children's Hospital that was initially established in 2014 to allow pediatric cardiovascular surgeons and adult congenital cardiologists to collaborate on patient cases, share best practices and combine outcome data. The expanded affiliation, now known as the Pediatric and Adult Congenital Heart Center, extends to all of pediatric cardiology and adult congenital cardiology, including clinical cardiology, imaging, interventional cardiology and cardiothoracic surgery. The new affiliation brings together a combined 30 pediatric cardiologists and surgeons from both organizations who specialize in children and adults with congenital heart disease.

## AKRON GENERAL HEALTH SYSTEM

The Clinic became the sole member of Akron General Health System (Akron General) in November 2015. During the operational integration process in early 2016, a compliance review conducted by the System of contractual relationships between Akron General and its independent physician practice groups identified a group of physician arrangements that were potentially non-compliant with the Federal Anti-Kickback Statute and the Limitations on Certain Physician Referrals regulation (commonly referred to as the Stark Law). Any noncompliance may have resulted in false claims to federal and/or state healthcare programs beginning in 2010 and could result in liability of Akron General under the Federal Anti-Kickback Statute, Stark Law, False Claims Act and/or other laws and regulations. The System voluntarily disclosed its concerns about these physician arrangements to the U.S. Department of Justice (DOJ) in May 2016. Akron General and the System have produced information to, engaged in discussions with, and are cooperating with the DOJ and related government authorities in connection with this matter.

Corrective actions have been taken by Akron General related to all of the physician arrangements at issue, and the Clinic has implemented its compliance programs at Akron General. Discussions with the DOJ and related government authorities about the physician arrangements are ongoing, though a timeframe for completion of the inquiry by the government authorities that may arise under the Federal Anti-Kickback Statute, Stark Law, False Claims Act and/or other related laws and regulations cannot be estimated at this time. The outcome of the ongoing dialogue with the DOJ is not expected to be material to the System or negatively impact the operations and/or financial condition of Akron General and/or the System.

## UNION HOSPITAL

In April 2018, the Clinic through a subsidiary became the sole member of The Union Hospital Association (Union Hospital) located in Dover, Ohio. Union Hospital operates a hospital and several off-campus satellite services. Union Hospital has more than 100 patient beds, 300 healthcare providers on staff, and 1,100 employees. In addition to Union Hospital, Union Hospital operates Tuscarawas Ambulatory Surgery Center and Union Physician Services, a

hospital-owned physician network with several offices and approximately 30 providers.

All services, programs and locations managed and operated by Union Hospital are being integrated into and/or aligned with the System. The integration process is examining the operations and procedures at the various entities and looking for ways to improve the quality and delivery of care. The Clinic previously maintained an existing relationship with Union Hospital through the Telestroke Network, which connects patients to the Clinic's Cerebrovascular Center.

## FLORIDA GROWTH

In January 2019, the Clinic through a subsidiary became the sole member of Martin Health System, located in Southeast Florida, approximately 100 miles north of Weston. Martin Health System is a regional not-for-profit, community-based healthcare provider consisting of three acute-care hospitals with approximately 513 staffed beds, a 150-member employed physician group and a network of outpatient services. As part of the agreement, the Clinic committed to invest at least $500 million into Martin Health System over five years to support strategic and capital needs, as well as other programs and services. The Clinic also will maintain certain clinical services at each of the Martin Health System hospitals for at least ten years. Martin Memorial Medical Center, a subsidiary of Martin Health System, became a member of the Obligated Group in May 2019.

In January 2019, the Clinic through a subsidiary became the sole member of Indian River Hospital, located in Southeast Florida approximately 130 miles north of Weston. Indian River Hospital is a not-for-profit medical center with approximately 250 staffed patient beds and is focused on providing healthcare to Indian River and surrounding counties in Florida. Under the terms of the transaction, the Clinic committed to invest at least $250 million in Indian River Hospital over the next decade and will maintain certain clinical services at Indian River Hospital for at least ten years. Indian River Hospital will continue to lease the hospital facilities and the land on which they stand under an amended and restated agreement with the Indian River County Hospital District for a term of up to 75 years.

Since the completion of the affiliations with Martin Health System and Indian River Hospital in January 2019, the services, programs and locations managed and operated by Martin Health System and Indian River Hospital are being integrated into and/or aligned with the Health System and their operations and procedures examined to look for opportunities to improve the quality and delivery of care.

## INTERNATIONAL GROWTH

In October 2015, the Clinic through a subsidiary acquired all of the share capital of 33 Grosvenor Place Limited (Grosvenor Place). Grosvenor Place is a limited liability company existing under Luxembourg law and a private company incorporated under Jersey law that has a long-term leasehold interest in a six-story 198,000 square-foot building in London, England. The System is converting the building from office space into an advanced healthcare facility that is expected to open in early 2021. For a description of the London hospital project, refer

to "EXPANSION AND IMPROVEMENT PROJECTS." A Chief Executive Officer has been appointed for Cleveland Clinic London, and senior leadership positions have been filled. The local leadership team is in the process of connecting with local physicians and third-party payors, recruiting additional staff and finalizing operational strategies in preparation of the 2021 opening.

In addition to the London project, the System operates a health and wellness center and a sports medicine clinic in Toronto, Canada, and provides management services to Cleveland Clinic Abu Dhabi, a multispecialty 364-staffed bed hospital offering critical and acute care services that opened in March 2015.

In 2017, the Clinic established Cleveland Clinic Connected, a global affiliation program that aims to improve patient care delivery around the world by enabling international health care providers to access the Clinic's best practices. The Clinic entered into its first Cleveland Clinic Connected relationship with Luye Medical Group to support the development of two hospitals in the Shanghai New Hong Qiao International Medical Center currently under development in Shanghai, China. Patients will experience the Clinic model of care through the Clinic's collaboration and guidance in the areas of quality, patient safety and best practices for patient care and engagement. Patients at the facilities have the option of receiving distance health and second opinions from the Clinic, and physicians at the facilities have access to clinical and executive education opportunities aimed at improving healthcare delivery. The Clinic will also support continuous improvement through the provision of advisory services across a spectrum of clinical and non-clinical areas.

These international activities have increased the diversity of the System's healthcare operations while promoting the Clinic's clinical expertise in new markets.

## STRATEGY

The U.S. healthcare industry continues to undergo dramatic change with the intersection of economic pressure, insurance reform, technological breakthroughs and demographic shifts. At the center of this change is a shift in reimbursement models from fee for service to value-based and risk-based payments. This ongoing payment shift is occurring both in commercial and government payer segments, requiring healthcare delivery organizations to rethink fundamental capabilities for managing care. Contributing to the reformation of healthcare is a new level of consumerism spurred by the continued growth of high-deductible health insurance products and expectations for transparency, customization, and on-demand solutions. As these changes take place, the combination of consolidation, a blurring of traditional roles, and new entrants with innovative business models and compelling customer value propositions are reordering the healthcare landscape.

The System has set forth a strategy that embraces these fundamental shifts and positions the organization for continued leadership and success in advancing its mission and meeting its goals in an uncertain and vastly changing healthcare environment. Anchoring the strategy is the System's belief that modern not-for-profit healthcare organizations must tend to four fundamental needs: care for the patients; care for the caregivers; care for the organization; and care for the community.

The strategy builds on the principles of the "Patients First" initiative started in 2013 by expanding and incorporating the four care priorities of patients, caregivers, community and organization. The strategic framework provides the System with the ability to prioritize activities and to focus on advancing the System's mission, vision, and values. In addition, the strategic framework addresses structural questions, including the formation of teams, governance of the System, allocation of resources and metrics to measure performance. In 2018, Cleveland Clinic launched several initiatives focused on important issues of quality, affordability, patient safety and caregiver wellbeing, including the following:


**Care Model -** Deliver innovative care across the continuum at the highest quality and value.

**Care Resource Optimization -** Develop a sustainable cost position.

**Caregiver Experience -** Make Cleveland Clinic the best place to work and grow in healthcare.

**Community -** Measurably improve well-being according to each community's unique needs.

**Education & Research -** Expand the foundation of education and research to enhance the mission of patient care.

**Growth -** Drive sustainable, transformative growth by securing core markets, expanding to new markets and serving more lives globally.

**Patient Experience -** Deliver an empathetic, seamless experience as a lifelong partner.

**Payer -** Enhance risk capabilities to drive performance across all payers and products.

**Physician Growth & Alignment -** Foster alignment and growth of the physician workforce.

**Technology -** Develop an industry leading digital and analytics platform.

In 2017, the System launched Cleveland Clinic Community Care, an institute created to better enable healthcare providers and teams to take care of patient populations. Cleveland Clinic Community Care is designed to bring primary care providers together under one umbrella – internal medicine, family medicine, hospital medicine, general pediatrics, wellness, home care and Express Care all report to the same unit. Primary care physicians are joined by advanced practice providers and medical assistants, who are supported by nurses, patient service representatives and care coordinators, working together to meet the needs of a specific group, or panel of patients. This single integrated care model brings together caregivers from primary and specialty care institutes and community providers in managing local populations and delivering community-based primary and chronic care. The model leverages data and an expanded care team to proactively address the health needs of populations.

As a major element of delivering value, an important thread through all of the priority initiatives of the clinical enterprise is care affordability – reducing the cost structure so that the System can be price competitive and render care more affordable for patients. In 2013, the System commissioned a Care Affordability Task Force to perform an enterprise-wide cost structure analysis and propose

recommendations for transformational cost and efficiency opportunities. The System is structured to continually monitor its use of resources in all clinical, operational and administrative areas. Since the inception of the program in 2014, management estimates that Care Resource Optimization initiatives and other localized efforts enabled more than $1 billion of improvements in the cost structure. The System continues to develop and implement cost management and containment plans for a more affordable care model and to enable investments in key strategic initiatives. This work is expected to be an ongoing effort.

In parallel with efforts to transform the care model, the System is redefining its relationships with payors and the payment system to match the broader industry trend toward value-based contracting. The System continues to explore increased forms of risk-taking in payer contracts including pay-for-performance, bundled payments, global risk contracts and narrow network arrangements with payer partners. The System has implemented various risk contracting initiatives, including the co-branded insurance products with payer partners launched in 2018 that focus on specific product and consumer segments.

Leadership also is executing a focused growth strategy, domestically and internationally. A major emphasis of the domestic agenda is focused on developing and maintaining relationships with selected physician groups and hospitals throughout Northeast Ohio and partnering with community physicians in aligned, yet different, models. In Florida, the System has begun implementation of a multi-year growth plan that includes expansion of services at current facilities, new ambulatory facilities in surrounding communities and acquisition of healthcare facilities in Southeast Florida. The System will focus and prioritize initiatives to better prepare the Florida facilities for value-based care, while enhancing its position as the regional referral center for complex care. Internationally, the System is focusing on building strong relationships with physicians and medical centers around the world through outreach offices, research/education efforts, and an expanded global footprint.

Over the past several years, the System has pursued digitalization of care through virtual visit and telemedicine programs. These programs are being used to deploy distance health capabilities to more systematically connect physicians, patients and health systems to extend patient access, improve experience, increase efficiency and explore new care delivery models. Patient access initiatives are focused on providing lower cost, efficient care alternatives for lower acuity medical conditions to System patients. In 2018, the System averaged over 3,500 monthly virtual visits.

Caregivers throughout the System continue to identify and pursue ways to improve on every dimension of the organization's performance: relentless pursuit of quality and safety; organization and delivery of care; effectuation of research and education; and the clearly conveyed message of the System's value to the community. The System is committed to a path not only to respond to the changes in the environment, but also to lead the field with novel approaches that preserve excellence in care while offering sustainable models for others to adopt.

## COMMUNITY BENEFIT AND ECONOMIC IMPACT

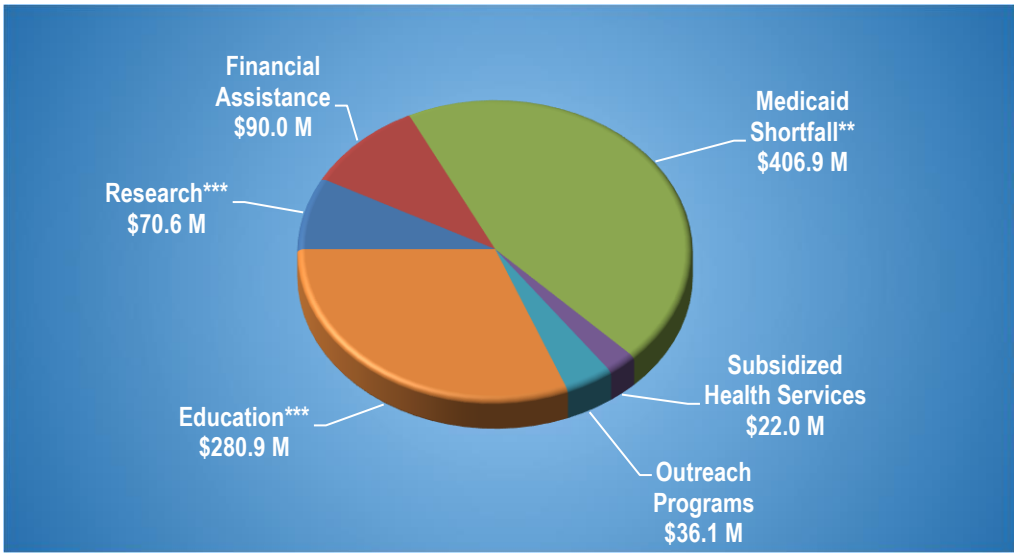
### Community Benefit

The Clinic and its hospital affiliates within the System are comprised of charitable, tax-exempt healthcare organizations. The System's mission includes addressing health service needs and providing benefits to the communities it serves. The tax-exempt members of the System must satisfy a community benefit standard to maintain their tax-exempt status. Community benefit reporting for the System conforms to Internal Revenue Service (IRS) requirements and is reported on the IRS Form 990, the information return required to be filed annually with the IRS by exempt organizations.

Community benefit includes activities or programs that improve access to health services, enhance public health, advance generalizable knowledge and relieve government burden. The primary categories for assessing community benefit include financial assistance, Medicaid shortfall, subsidized health services, outreach programs, education and research.

In 2017, the System provided $906.5 million in benefits to the communities it serves. Community benefit information for 2018 was not available at the time of issuance of this Management Discussion and Analysis. The following chart summarizes community benefits for the System:

**Cleveland Clinic Health System***
**Breakdown of Community Benefit (2017)**
**$906.5 Million**




* Includes all System operations in Ohio, Florida and Nevada
** Includes net Hospital Care Assurance Program assessment of $8.3 million
*** Research and Education are reported net of externally sponsored funding of $159.7 million.

**Financial Assistance**: Financial Assistance represents the cost of providing free or discounted medically necessary care to patients unable to pay some or all of their medical bills. The System's financial assistance policy provides free or discounted care to uninsured patients with incomes up to 400 percent of the federal poverty level and who meet certain other eligibility criteria by state. This policy covers both hospital care and services provided by the System's employed physicians. As a result of the Affordable Care Act implementation over the last few years, which previously required individuals to obtain healthcare insurance, nonprofit hospitals across the United States saw an increase of individuals covered by Medicaid or health exchange policies.

**Medicaid Shortfall**: The System is a leading provider of Medicaid services in Ohio. The Medicaid program provides healthcare coverage for low-income families and individuals and is funded by both the state and federal governments. Medicaid shortfall represents the difference between the costs of providing care to Medicaid beneficiaries and the reimbursement received by the System.

**Subsidized Health Services**: Subsidized health services yield low or negative margins, but these programs are needed in the community. Subsidized health services provided in the System include pediatric programs, psychiatric/behavioral health programs, obstetrical services, chronic disease management and outpatient clinics.

**Outreach Programs**: The System is actively engaged in a broad array of community outreach programs, including numerous initiatives designed to serve vulnerable and at-risk populations in the community. Outreach programs typically fall into three categories: community health services; cash and in-kind donations; and community building. The System's outreach programs include wellness initiatives, chronic disease management, clinical services, free health screenings, and enrollment assistance for government funded health programs. A few of the System's community outreach initiatives are highlighted below:

- The System provided no-cost clinical care to under- and uninsured families at community sites. For example, the Langston Hughes Health and Education Center, a Fairfax neighborhood site, provided multigenerational prevention and wellness services.
- Health fairs provided thousands of people with free screenings for diabetes, heart disease, cancer and other health conditions. The Cleveland Clinic Minority Men's Health Fair, Celebrating Sisterhood, Tu Familia and dozens of other community health fairs educated community members on the benefits of preventive healthcare.
- Wellness initiatives and community education classes were provided to schools, faith-based organizations and community centers in the areas of prevention, chronic disease management and behavioral change, including tobacco cessation, weight management, teen parenting, family violence and child safety.
- Collaborative initiatives with community nonprofits and local governments addressed critical population issues, including the opioid epidemic and infant mortality.
- Physical education, training and concussion awareness were provided to high school students by the Clinic's Orthopedic and Rheumatology Institute. The Pediatric Mobile Unit provided wellness services to local elementary schools.
- The Clinic's Robert J. Tomsich Pathology & Laboratory Medicine Institute donated services to area safety-net providers.

**Education**: The System provides a wide range of high-quality medical education, including accredited training programs for residents, physicians, nurses and other allied health professionals. The System maintains one of the largest graduate medical education programs in the nation. At the postgraduate level, the System's Center of Continuing Education has developed one of the largest and most diverse continuing medical education programs in the world. The System also operates Cleveland Clinic Lerner College of Medicine of Case Western Reserve University, dedicated to the teaching of physician-scientists.

**Research**: From a community benefit perspective, medical research includes basic, clinical and community health research, as well as studies on healthcare delivery. Community benefits include research activities supported by government and foundation sources; corporate and other grants are excluded from community benefits. The System uses internal funding to cover shortfalls in outside resources for research.

## Community Health Needs Assessment

The System completes comprehensive community health needs assessments (CHNA) once every three years for each hospital. Internal Revenue Code Section 501(r)(3) requires nonprofit hospital organizations to conduct a CHNA every three years and adopt an implementation strategy to identify the community health needs that each hospital will address.

To obtain an in-depth understanding of the community risk indicators, population trends and healthcare needs, the System has gathered and will gather various data, including:

- demographic and health statistical data;
- information on socio-economic barriers to care, including income, culture, language, education, insurance and housing;
- national, state and local disease prevalence;
- health behavior; and
- medical research and health professional education.

Information is also gathered from persons representing the broad interests of the community, including those with special knowledge or expertise in public health.

Key CHNA needs identified throughout the System include:

- chronic disease (heart disease, cancer, diabetes, asthma, obesity);
- health conditions (mental health, poor birth outcomes, aging, chemical dependency);
- wellness (nutrition, exercise, tobacco cessation, preventative care);
- access to affordable healthcare;
- education (physician shortage); and
- medical research.

Hospital implementation strategies that address the health needs identified in the assessments have been developed by individual hospital leadership teams and have been added to the Clinic's website in compliance with the regulatory requirements. The current CHNA reports and implementation strategies for the System hospitals are available on the Clinic's website (www.clevelandclinic.org/CHNAReports).

### Economic Impact

The System is the largest employer in the State of Ohio. The System's most recent Economic and Fiscal Impact Report was released in 2018 and was based on 2016 data, the most current data available at that time. In 2016 the System generated $17.8 billion of the total economic activity in Ohio and has directly and indirectly supported more than 119,000 jobs generating approximately $7.5 billion in wages and earnings. The System's economic activity was accountable for $2.25 billion in federal income taxes paid by employees and vendors and $987 million in total state and local taxes. System-supported households spent $5 billion on goods and services. The System has purchased almost $1.8 billion of goods and services from Ohio businesses. Between 2014 and 2016, the System's construction projects have invested almost $808 million in real property improvements, including renovating existing structures, building new facilities, and improving properties in Ohio. The System continues to contribute significant economic and fiscal value to the State of Ohio and support businesses and professional services across the state. In addition to Ohio, the System contributed $1.2 billion in total economic output in the State of Florida and $47 million of total economic output in the State of Nevada.

The System's Economic and Fiscal Impact Report is the result of an economic analysis completed by the Silverlode Consulting Corp. The report was completed in part using the IMPLAN® economic impact model, which is used by more than 1,000 universities and government agencies to estimate economic and fiscal impacts. Additional information regarding the System's economic impact is available on the Clinic's website (www.clevelandclinic.org/economicimpact).

## SUSTAINABILITY

The System supports healthy environments for healthy communities, recognizes the link between environmental and human health and strives to responsibly address and mitigate its environmental impacts. As a national leader in healthcare, the System is in a position to lead by example in the adoption of environmental best practices.

The System's Office for a Healthy Environment acknowledges its obligation and opportunity to minimize the health impacts of climate change. The System is working to enhance the resilience of its facilities and communities, engaging its stakeholders to personalize climate action and embedding sustainability into its healthcare delivery model.

As a leader in the healthcare industry, the System has publically committed to compiling an annual sustainability report for its patients, caregivers, communities and global stakeholders through two leading international frameworks: The United Nations Global Compact and the Global Reporting Initiative. The compilation, titled "Serving Our Present, Caring for Our Future," includes performance metrics and stories, highlights accomplishments and communicates challenges as the System strives to reach its goals. The complete report is available on the Clinic's website (www.clevelandclinic.org/ungc).

The Clinic is a member of Practice Greenhealth, the nation's leading healthcare community that empowers its members to increase their

efficiencies and environmental stewardship while improving patient safety and care through tools, best practices and knowledge. In 2019, the Clinic won the Top 25 Environmental Excellence Award for the fifth straight year. This award recognizes healthcare facilities that exemplify environmental excellence and are setting the highest standards for environmental practices in healthcare. Award winners are chosen from hospitals that have the highest scores using Practice Greenhealth's thorough scoring and evaluation system. The Clinic was also recognized for being in the top ten in the nation in four Circles of Excellence: Climate, Energy, Green Building and Greening the OR. Other System entities and facilities were honored in 2019 with additional Practice Greenhealth Environmental Excellence Awards for outstanding performance in healthcare sustainability.

The System's energy program is designed to enhance patient outcomes and the patient experience while reducing operating expenses. As the model of healthcare evolves, the System is committed to reducing environmental, economic and human impact by reducing energy intensity. The System's commitments to both affordable care and external partnerships with ENERGY STAR and the Better Buildings Challenge have created goals of becoming 20% more energy efficient by 2020 from a 2010 baseline on more than 20 million square feet of facilities. Initiatives include a combination of critical energy efficiency projects and broad occupant education and engagement campaigns. From the December 2010 baseline, the System has realized a 19% reduction in weather normalized source energy use intensity for in-scope and reportable facilities.

A central component of the Systems' ongoing commitment to responsible energy management is to construct buildings that conform to the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED). LEED is a third-party certification program and the nationally accepted benchmark for design, construction and operation of environmentally responsible and energy-efficient buildings. All new major construction projects for the System follow LEED standards, with a goal of achieving gold certification. Construction projects also emphasize recycling of debris, with current diversion rates of up to 98% in recent years.

The System currently has 16 LEED-certified buildings, with additional buildings pending certification. The System has four buildings that are certified LEED-Gold, including the Global Cardiovascular Innovations Center, Marymount Hospital Surgical Expansion, Twinsburg Family Health and Surgery Center and the Tomsich Pathology Laboratories building.

In 2018, the Clinic's Center for Functional Medicine suite located on the Clinic's main campus achieved WELL certification, a new building standard that integrates human health into building design and operation. The WELL Certification process involves rigorous testing and a final evaluation carried out by the Green Business Certification Inc., which is the third-party certification body for the WELL Building Standard. WELL certification focuses on seven main concepts: air quality, water quality, healthy foods, light quality, integration of fitness, comfortable and productive workspaces, cognitive and emotional health and support for innovative features that impact the interaction between building and human health. The Center for Functional Medicine is one of the first medical offices to be awarded this certification.

## DIVERSITY

The System provides healthcare services to patients and families from a global community. The Office of Diversity and Inclusion (ODI), created in 2006, makes diversity, inclusion and cultural competence a critical part of the System's mission with a goal of creating a culture where caregivers integrate diversity and inclusion throughout the enterprise. ODI provides strategic direction that builds cultural competence, cultivates an inclusive organization, promotes safety, quality, and health equity, develops talent, and supports a diverse population of caregivers and patients. Its programs include cultural competence training, diversity councils, employee resource groups (ERG), language enrichment, consultation and pipeline development programs.

In 2019, the System was ranked first on the list of the country's top six healthcare organizations for diversity management practices by DiversityInc. The System has made this list for the tenth consecutive year. Rankings are empirically driven and assess performance based on a number of factors including talent pipeline, talent development, leadership accountability and supplier diversity. In addition, the Clinic's ERGs were ranked among the nation's best by PRISM international for the fourth consecutive year, with SALUD ranking fifth, ClinicPride ranking fourteenth, and Military/Veterans ranking seventeenth.

The System ranked in the top 25% of 500 corporations for diversity efforts on the Forbes list of Best Employers for Diversity for 2019. To determine the rankings, 50,000 Americans, working for businesses with at least 1,000 employees, were surveyed. Participants were asked to openly and anonymously share their opinions and rate their organizations on age, gender, ethnicity, disability, sexual orientation equality, general diversity and other criteria. This is the second year the System was recognized.

The SALUD ERG sponsored program, ACTiVHOS™, received financial support and approval to expand in 2019. ACTiVHOS™ stands for "Activity, Cognitive Therapy, and Incentives in Health Outreach for Students" and is the first and only bilingual/bi-cultural youth wellness program in Northeast Ohio. It was started by SALUD, the System's Hispanic/Latino ERG with support from ODI.

In May 2019, the Clinic was awarded the 2019 Best in Class Award in the category of "Workforce Diversity" by the Greater Cleveland Partnership. The Partnership's Commission on Economic Inclusion works with Northeast Ohio employers to make diversity a source of economic strength. The Clinic was selected from more than 100 organizations for the award, which was based on an assessment that measured the strategy and development of inclusion initiatives at the Clinic in comparison to other businesses of similar size and type.

## CONFLICT OF INTEREST

The System maintains policies that require internal reporting of outside financial and fiduciary interests to ensure that potential conflicts of interests do not inappropriately influence research, patient care, education, business or professional decision making. In connection with these policies, the System developed the Innovation Management and

Conflict of Interest Program, which is designed to promote innovation while at the same time reducing, eliminating or managing real or perceived bias either due to System personnel consulting with pharmaceutical, medical device and diagnostic companies (industry) or the commercialization efforts undertaken by the System to develop discoveries and make them accessible to patients. The Program works with physicians, managers and other employees who interact with industry to manage any conflicts. Provisions related to whether or not "compelling circumstances" are required to justify conducting research in the presence of related financial interests have been modified in policies that went into effect in 2013, consistent with the value the System places on beneficial relationships with industry. The System is committed to a process that maintains integrity in innovation and places the interests of its patients first. The Innovation Management and Conflict of Interest Program reviews situations in which a physician or other clinician prescribes or uses products of a company in their practice and has a financial relationship with that company. When appropriate, the Program will put management in place to address any conflict (for example, by disclosure). The goal of this policy is not to interfere with the practice of medicine.

An initiative to bring transparency to the System's relationships with industry has been in place since 2008 in which the specific types of interactions that individual physicians and scientists have with industry were disclosed on publicly-accessible web pages on the System's internet site. Information can be accessed by patients that describes the training, type of practice and accomplishments of a specific doctor or scientist, as well as the names of companies with which the doctor has financial or fiduciary relations as an inventor, consultant, speaker or board member. These disclosures are updated regularly. The System was the first academic medical center in the country to have made these interactions public. Many other academic medical centers have followed the System's lead by providing similar disclosures. The System maintains a Conflict of Interest in Education Policy to reflect its values and represent its and its employees' best interests. This policy is responsive to guidelines from the Association of American Medical Colleges, the Institute of Medicine and other organizations. It places restrictions on outside speaking activities that are not Accreditation Council for Continuing Medical Education approved and are generally considered marketing. Speakers must present content that is data-driven and balanced; speakers must create their own slides or use only unbranded slides created by industry. This policy puts the System in step with other top academic medical centers that have already banned speaker's bureaus. In addition, the policy requires instructors to disclose relevant financial interests with companies to trainees.

The Innovation Management and Conflict of Interest Committee of the System has also established processes with cross-membership and seamless interactions and communications with the Board of Directors' Conflict of Interest and Managing Innovations Committee.

Board members of the Clinic and the regional hospitals in the System are required to complete annual disclosure questionnaires. These questionnaires are designed to identify possible conflicts of interest that may exist and ensure that any such conflicts do not inappropriately influence the operations of the System. The information obtained from these questionnaires is used to respond to the related-party transactions and other disclosures required by the IRS on Form 990. The Form 990 for the Clinic and for the System are available on the Clinic's website, as well as additional information regarding the Clinic's Board of Directors and any business relationships the Directors may have with the System.

## ENTERPRISE RISK MANAGEMENT

The System maintains a multi-phase enterprise risk management (ERM) process to develop a formal and systematic approach to the identification, assessment, prioritization and reporting of risks. The process is closely linked with the System's strategic and annual planning. The ultimate objective is to create an enterprise-wide risk management model that contains sustainable reporting and monitoring processes and embeds risk management into the System's culture, in order to more effectively mitigate risks. The System established an ERM Steering Committee and engaged a consulting firm to support this process.

In the ERM process, risk identification is conducted resulting in a System risk profile that categorizes individual risks based on their impact upon the System's ability to meet its strategic objectives. During this process, certain risks are identified as top risks and then further separated into sub-risks and individual risk components. Extensive risk assessments and mitigation analyses have been prepared whereby risk components are evaluated according to their likelihood of occurring and potential impact should they occur. Risk mitigation activities, including risk response effectiveness, are examined, reviewed and updated as part of this process. The most recent comprehensive evaluation of top risks was concluded in the second quarter of 2019. ERM is an on-going program, with regular reporting to senior management, including the Audit Committee of the Board of Directors, the body with oversight responsibility for ERM.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

The System regularly evaluates its internal control environment over the System's financial reporting processes through an initiative based upon concepts established in the Sarbanes-Oxley Act of 2002. The goals of the initiative are to ensure the integrity and reliability of financial information, strengthen internal control in the reporting process, reduce the risk of fraud and improve efficiencies in the financial reporting process. The initiative reviews all aspects of the financial reporting process, identifies potential risks and ensures that they have been mitigated utilizing a management self-assessment process. As a result of this initiative, management of the System issued a report on the effectiveness of its internal control over financial reporting as part of the issuance of its consolidated financial results for 2018, which is the tenth year the management report was completed. As part of the internal control evaluation process for 2018, certifications were completed by 135 members of System management, including top leadership. The System is one of the first not-for-profit hospitals to issue a management report on the effectiveness of internal control over financial reporting, a step that further increases the transparency of the organization. System management updates the certification on a quarterly basis. There were no changes in internal controls over financial reporting during the six months ended June 30, 2019 that have materially affected, or are likely to materially affect, the internal controls over financial reporting for the System.

## INDUSTRY OUTLOOK

In December 2018, Moody's maintained its negative outlook for the U.S. not-for-profit healthcare and hospital sector, an outlook it has maintained since December 2017. Moody's expects operating cash flow to remain unchanged or decrease in the next year. The negative outlook also reflects Moody's expectation that hospital bad debt will continue to rise, predicting an 8%-9% growth in the next year as health plans place increased financial responsibility on patients. Moody's also predicts that an aging population will increase hospital reliance on Medicare, which may also constrain revenue growth. In August 2018, Moody's released medians for the U.S. not-for-profit healthcare and hospital sector that showed operating cash flow decreased to 8.1% for fiscal year 2017, which is the lowest level seen since the 2008/2009 recession.

In January 2019, S&P maintained its stable outlook for the U.S. not-for-profit healthcare sector. S&P based its rating on the strength of the balance sheets in the sector, a long-term trend of improving business profiles primarily from mergers and acquisitions and a growing array of diversifying joint ventures. However, S&P does acknowledge that operating risks for some organizations exist, including a potential recession, continued Medicaid changes, increased traction from nontraditional competitors, and heightened cost and revenue pressure in part due to an aging population. S&P expects there to be continued uncertainty in the industry due to the various challenges and court rulings related to the Affordable Care Act. Rating performance in 2018 showed a generally even level of upgrades and downgrades, with approximately 81% of the rated portfolio with stable outlooks.

The System continues to anticipate, and remains alert to, changes in the healthcare market and is committed to formulating and implementing financial and strategic plans necessary to meet the System's strategic objectives and to enable the System to remain a recognized world leader in healthcare. To that end, System management continually monitors the environment in which it operates and evaluates the ways in which it conducts business.


**Lorain Family Health Center**
**Lorain, Ohio**

## PATIENT VOLUMES

The following table summarizes patient volumes for the System on a pro forma basis including Union Hospital, Martin Health System, and Indian River Hospital for all periods presented:

**Utilization Statistics**

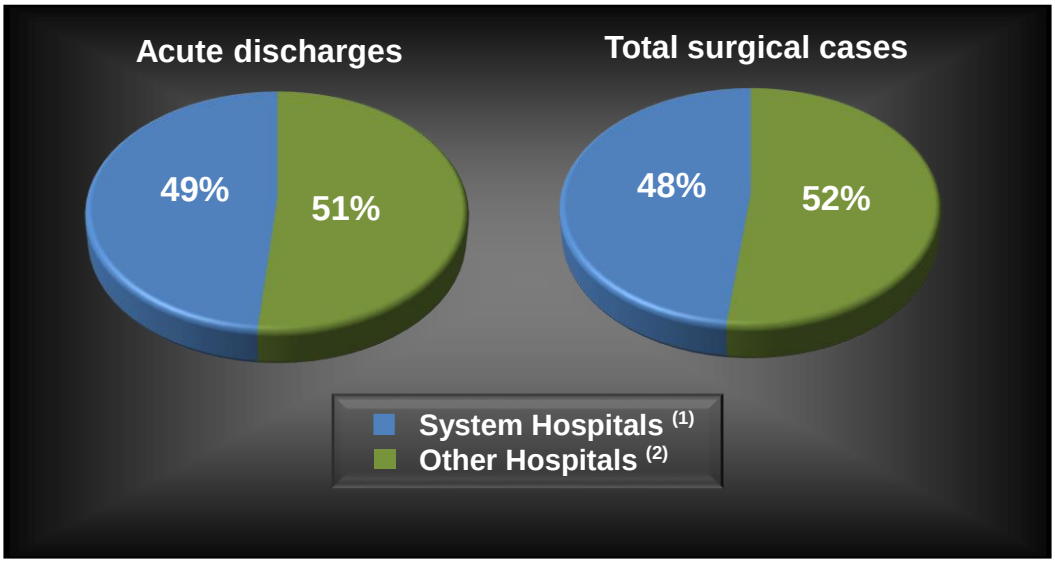
| | For the quarter ended June 30 | | | | For the six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | 2018 | Variance | % | 2019 | 2018 | Variance | % |
| Inpatient admissions[(1)] | | | | | | | | |
| Acute admissions | 56,320 | 53,457 | 2,863 | 5.4% | 111,275 | 107,677 | 3,598 | 3.3% |
| Post-acute admissions | 2,866 | 3,264 | -398 | -12.2% | 5,719 | 6,303 | -584 | -9.3% |
| | 59,186 | 56,721 | 2,465 | 4.3% | 116,994 | 113,980 | 3,014 | 2.6% |
| Patient days[(1)] | | | | | | | | |
| Acute patient days | 271,414 | 267,876 | 3,538 | 1.3% | 547,504 | 544,826 | 2,678 | 0.5% |
| Post-acute patient days | 20,826 | 22,482 | -1,656 | -7.4% | 42,287 | 44,546 | -2,259 | -5.1% |
| | 292,240 | 290,358 | 1,882 | 0.6% | 589,791 | 589,372 | 419 | 0.1% |
| Surgical cases | | | | | | | | |
| Inpatient | 18,711 | 18,155 | 556 | 3.1% | 36,574 | 36,579 | -5 | 0.0% |
| Outpatient | 45,841 | 43,139 | 2,702 | 6.3% | 90,236 | 84,609 | 5,627 | 6.7% |
| | 64,552 | 61,294 | 3,258 | 5.3% | 126,810 | 121,188 | 5,622 | 4.6% |
| Emergency department visi | 220,425 | 214,991 | 5,434 | 2.5% | 439,058 | 436,247 | 2,811 | 0.6% |
| Observations | 21,085 | 19,559 | 1,526 | 7.8% | 43,434 | 40,038 | 3,396 | 8.5% |
| Clinic outpatient evaluation and management visits | 1,595,926 | 1,478,160 | 117,766 | 8.0% | 3,167,239 | 2,960,090 | 207,149 | 7.0% |

[(1)] Excludes newborns

Inpatient acute admissions for the System increased 5% in the second quarter of 2019 and 3% during the first six months of 2019 compared to the same periods in 2018. For the first six months of 2019, acute admissions for the System in the Northeast Ohio area increased 2% compared to 2018, while the Florida facilities experienced an 8% increase in acute admissions over the same period. According to data from the Center for Health Affairs, acute discharges excluding newborns for hospitals in the Cleveland metropolitan area decreased 1% in the first six months of 2019 compared to the same period in 2018.

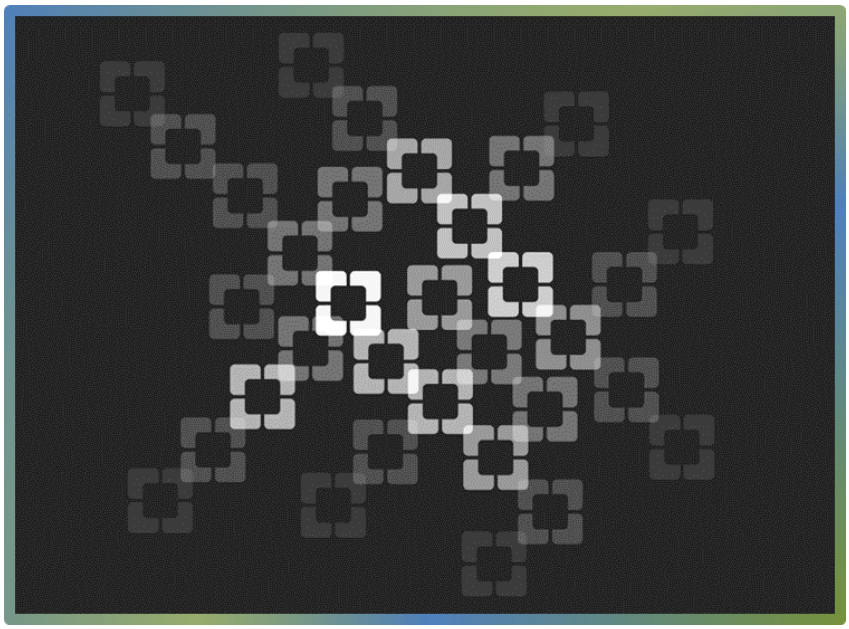
Total surgical cases for the System increased 5% in both the second quarter of 2019 and the first six months of 2019 compared to the same periods in 2018. For the first six months of 2019, total surgical cases for the System in the Northeast Ohio area increased 6%, while the Florida facilities remained flat over the same period. The surgical mix of total surgical cases for the System for the first six months of 2019 was 29% inpatient and 71% outpatient, which represents an approximately 1% shift from inpatient to outpatient compared to the pro forma surgical mix for the same period in 2018.

The following charts summarize selected statistical information for Cleveland metropolitan hospitals for the three months ended June 30, 2019:




*Source: The Center for Health Affairs Volume Statistics*

(1) "System Hospitals" excludes Florida, Akron General, and Union Hospital facilities and includes Ashtabula County Medical Center.
(2) "Other Hospitals" includes all other hospitals in the Cleveland metropolitan area reported by the Center for Health Affairs that are not included in System hospitals.



## LIQUIDITY

### Cash and Investments

The System's objectives for its investment portfolio are to target returns over the long-term that exceed the System's capital costs so as to optimize its asset/liability mix and preserve and enhance its strong financial structure. The asset allocation of the portfolio is broadly diversified across global equity and global fixed income asset classes and alternative investment strategies and is designed to maximize the probability of achieving the long-term investment objectives at an appropriate level of risk while maintaining a level of liquidity to meet the needs of ongoing portfolio management. This allocation is formalized into a strategic policy benchmark that guides the management of the portfolio and provides a standard to use in evaluating the portfolio's performance.

Investments are primarily maintained in a master trust fund administered using a bank as custodian. The Cleveland Clinic Investment Office (CCIO) is charged with the day-to-day management of the System's investments and their strategic direction. These portfolios include the System's general long-term investment portfolio, its defined benefit pension fund and the captive insurance fund. The System has established formal investment policies that support the System's investment objectives and provide an appropriate balance between return and risk.

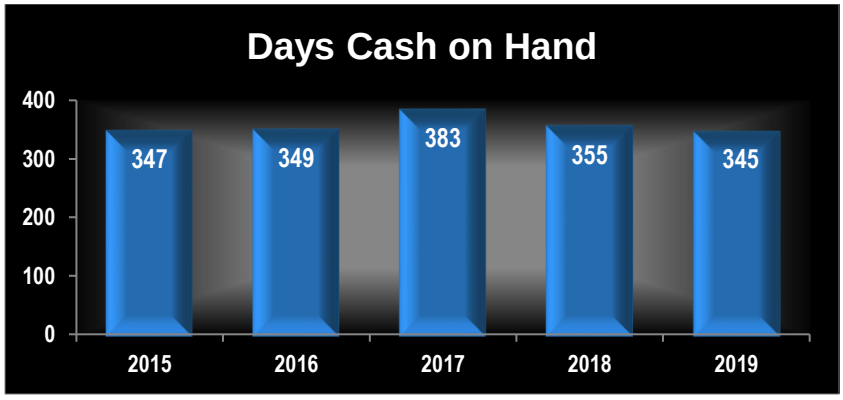
The following table sets forth the allocation of the System's cash and investments in its general long-term investment portfolio and captive insurance fund at June 30, 2019 and December 31, 2018:

**Cash and Investments**
**(Dollars in thousands)**

| | June 30, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| Cash and cash equivalents | $ 1,461,732 | 15% | $ 911,877 | 10% |
| Fixed income securities* | 2,767,817 | 27% | 2,509,157 | 28% |
| Marketable equity securities* | 2,832,841 | 28% | 2,777,199 | 31% |
| Alternative investments | 2,970,951 | 30% | 2,735,233 | 31% |
| Total cash and investments | $10,033,341 | 100% | $ 8,933,466 | 100% |
| Less restricted investments** | (1,250,928) | | (955,035) | |
| Unrestricted cash and investments | $ 8,782,413 | | $ 7,978,431 | |
| Days cash on hand | 345 | | 355 | |

* Fixed income securities and marketable equity securities include mutual funds and commingled investment funds within each investment allocation category.
** Restricted investments include funds held by trustees, assets held for self-insurance and donor restricted assets.

The following chart summarizes days cash on hand for the System at December 31 for the last four years and at June 30, 2019:




At June 30, 2019, total cash and investments for the System (including restricted investments) were $10.0 billion, an increase of $1.1 billion from $8.9 billion at December 31, 2018. Cash inflows consist of cash provided by operating activities and related investment income of $757 million, net proceeds from the issuance of long-term borrowings of $721 million, a net increase in restricted gifts and income of $107 million, foreign exchange gains on cash and cash equivalents of $1 million and cash and investments of $265 million received by the System from the Martin Health System and Indian River Hospital member substitution business combinations. Cash inflows were offset by net capital expenditures of $467 million and principal payments on debt of $284 million. Days cash on hand for the System in the first six months of 2019 benefited from positive investment returns but was diluted as a result of the Martin Health System and Indian River Hospital member substitution business combinations.

Included in the System's cash and investments are investments held for self-insurance. These investments totaled $210.5 million at June 30, 2019, with an asset mix of 24% cash and short-term investments, 38% fixed-income securities, 17% equity investments and 21% alternative investments. The asset mix reflects the need for liquidity and the objective to maintain stable returns utilizing a lower tolerance for risk and volatility consistent with insurance regulatory requirements.

Also included in the System's cash and investments at June 30, 2019 are $232.4 million of funds held by trustees. Funds held by trustees include $68.5 million of posted collateral. Collateral is comprised of $0.1 million related to a futures and options program within the System's investment portfolio and $68.4 million related to the System's interest rate swap contracts. The swap contracts require that collateral be posted when the market value of a contract in a liability position exceeds a certain threshold. The collateral is returned as the liability is reduced. Unexpended bond proceeds from the bonds issued in May 2019 totaled $162.8 million at June 30, 2019. These amounts will be used to reimburse the System for capital expenditures in future periods. The System also has $1.1 million of funds held by trustee for other purposes. Investment objectives of funds held by the trustees are designed to preserve principal by investing in highly liquid cash or fixed-income investments. At June 30, 2019, the asset mix of funds held by trustees was 71% cash and short-term investments and 29% fixed-income securities.

The System invests in alternative investments to increase the portfolio's diversification. Alternative investments are primarily limited partnerships that invest in marketable securities, privately held securities, real estate, and derivative products and are reported using the equity method of accounting based on information provided by the respective partnership.

Alternative investments at June 30, 2019 and December 31, 2018 consist of the following:

**Alternative Investments**
**(Dollars in thousands)**

| | June 30, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| Hedge funds | $ 1,597,006 | 54% | $ 1,357,553 | 50% |
| Private equity/venture capital | 1,073,418 | 36% | 1,007,692 | 37% |
| Real estate | 300,527 | 10% | 369,988 | 13% |
| Total alternative investments | $ 2,970,951 | 100% | $ 2,735,233 | 100% |

Alternative investments have varying degrees of liquidity and are generally less liquid than the traditional equity and fixed income classes of investments. Over time, investors may earn a premium return in exchange for this lack of liquidity. Hedge funds typically contain redeemable interests and offer the most liquidity of the alternative investment classes. These investment funds permit holders periodic opportunities to redeem interests at frequencies that can range from daily to annually, subject to lock-up provisions that are generally imposed upon initial investment in the fund. It is common, however, that a small portion (5-10%) of withdrawal proceeds are held back from distribution pending the fund's annual audit, which can be up to a year away. Private equity, venture capital, and real estate funds typically have non-redeemable partnership interests. Due to the inherent illiquidity of the underlying investments, the funds generally contain lock-up provisions that prohibit redemptions during the fund's life. Distributions from the funds are received as the underlying investments in the fund are liquidated. These investments have an initial subscription period, under which commitments are made to contribute a specified amount of capital as called for by the general partner of the fund. The System periodically reviews unfunded commitments to ensure adequate liquidity exists to fulfill anticipated contributions to alternative investments.

## Investment Return

Return on investments, including equity method income on alternative investments, is reported as nonoperating gains and losses except for earnings on funds held by bond trustees and interest and dividends earned on assets held by the captive insurance subsidiary, which are included in other unrestricted revenues. Donor restricted investment return on restricted investments is included in net assets with donor restrictions.

The System's long-term investment portfolio, which excludes assets held for self-insurance, reported investment gains of 2.0% for the second quarter of 2019, which is the same as the portfolio's benchmark and higher than investment losses of 0.2% for the second quarter of 2018. For the first six months of 2019, the System experienced investment gains of 7.4%, which is lower than the portfolio's benchmark gains of 10.4% and higher than the investment

gains of 0.2% experienced for the first six months of 2018. The variance to the benchmark was primarily in private investments that use public equity benchmarks due to the limited availability of benchmarks for private investments.

Total investment return for the System is comprised of the following:

**Investment Return**
**(Dollars in thousands)**

| | For the quarter ended June 30 | | For the six months ended June 30 | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Other unrestricted revenue: | | | | |
| Interest income and dividends | $ 678 | $ 533 | $ 1,168 | $ 1,161 |
| Nonoperating gains and losses, net: | | | | |
| Interest income and dividends | 24,446 | 21,368 | 42,391 | 36,565 |
| Net realized gains on sales of investments | 58,354 | 71,640 | 107,824 | 139,278 |
| Net change in unrealized gains (losses) on investments | 43,336 | (138,293) | 321,756 | (195,163) |
| Equity method income on alternative investments | 63,161 | 52,178 | 95,625 | 69,782 |
| Investment management fees | (7,605) | (7,724) | (14,264) | (14,189) |
| | 181,692 | (831) | 553,332 | 36,273 |
| Other changes in net assets: | | | | |
| Investment income on restricted investments and other | 16,265 | 1 | 42,273 | 201 |
| Total investment return (loss) | $198,635 | $ (297) | $ 596,773 | $ 37,635 |

**Long-term Debt**

At June 30, 2019, outstanding current and long-term debt for the System excluding unamortized premium and unamortized debt issuance costs totaled $4.8 billion, comprised of $4.7 billion in bonds and notes and $119 million in finance leases. Bonds and notes are structured with approximately 75% fixed-rate debt and 25% variable-rate debt. The System utilizes various interest rate swap derivative contracts to manage the risk of increased debt service resulting from rising market interest rates on variable-rate bonds. The total notional amount on the System's interest rate swap contracts at June 30, 2019 was $623 million. Using an interest rate benchmark, these contracts convert variable-rate debt to a fixed-rate, which further reduces the System's exposure to variable interest rates. The interest rate swap contracts can be unwound by the System at any time, whereas the counterparty has the option to unwind the contracts only upon an event of default as defined in the contracts.

In May 2019, hospital revenue bonds totaling $966.5 million were issued for the benefit of the System. The proceeds of these bonds have been or will be used to acquire the ownership interest in Martin Health System, acquire facilities previously leased by the System under operating

lease agreements, finance certain capital expenditures of the System and pay the cost of issuance. Contemporaneously with the issuance of the bonds in 2019, the System also defeased certain debt previously incurred by Martin Health System. For a description of the bonds issued in 2019, refer to "FINANCING DEVELOPMENTS."

As of June 30, 2019, approximately $663 million of variable-rate debt is secured by irrevocable direct pay letters of credit or standby bond purchase agreements or is directly placed with a financial institution. Debt supported by letters of credit or standby bond purchase agreements that expire within one year, require repayment of a remarketing draw within one year, or contain a subjective clause that would allow the lender to declare an event of default and cause immediate repayment of such bonds are classified as current liabilities. The Series 2019E Bonds and Series 2019F Bonds issued in May 2019 added a total of $260.8 million of variable-rate debt supported by standby bond purchase agreements to the System.

As of June 30, 2019, approximately $401 million of variable-rate debt is supported by the System's self-liquidity program. Debt supported by self-liquidity includes the Series 2014A CP Notes and certain variable-rate bonds that are remarketed in commercial paper or weekly mode. Debt supported by self-liquidity are classified as current liabilities. The Series 2019D Bonds issued in May 2019 added $119.3 million to the System's self-liquidity program. The System has sufficient liquidity within its investment portfolio to support the self-liquidity program. The System also maintains a $400 million revolving credit facility that can be drawn upon in the case of a failed remarketing of self-liquidity debt. The revolving credit facility expires in May 2022 and bears interest at a variable rate based on various interest rate benchmarks and spreads. There were no amounts outstanding under the revolving credit facility at June 30, 2019.

The System maintains the Cleveland Clinic Health System Obligated Group Commercial Paper Program (CP Program), which provides for the issuance of the Series 2014A CP Notes. The CP Program was established in November 2014 and will terminate no later than January 2044. The Series 2014A CP Notes may be issued from time to time in a maximum outstanding face amount of $100 million and are supported by the System's self-liquidity program. At June 30, 2019, the System did not have any outstanding Series 2014A CP Notes.

In the second quarter of 2019, the Clinic terminated a $300.0 million revolving credit facility with multiple financial institutions. The revolving credit facility was scheduled to expire in 2019. The facility allowed the Clinic to enter into short-term loans that automatically renewed throughout the term of the facility. The revolving credit facility bore interest at a variable rate based on the LIBOR index plus an applicable spread. Amounts outstanding on the revolving credit facility at December 31, 2018 totaled $105.0 million. The Clinic paid the full amount of the revolving credit facility in April 2019.

In August 2018 the System through a UK subsidiary entered into a private placement agreement to issue the 2018 Sterling Notes totaling £665 million. The subsidiary received proceeds of £300 million, £100 million and £265 million in August 2018, November 2018 and August 2019, respectively. The outstanding 2018 Sterling Notes have been converted to U.S. dollars in the consolidated balance sheet using the respective exchange rate at June 30, 2019 and December 31, 2018. For a description of the 2018 Sterling Notes, refer to "FINANCING DEVELOPMENTS."

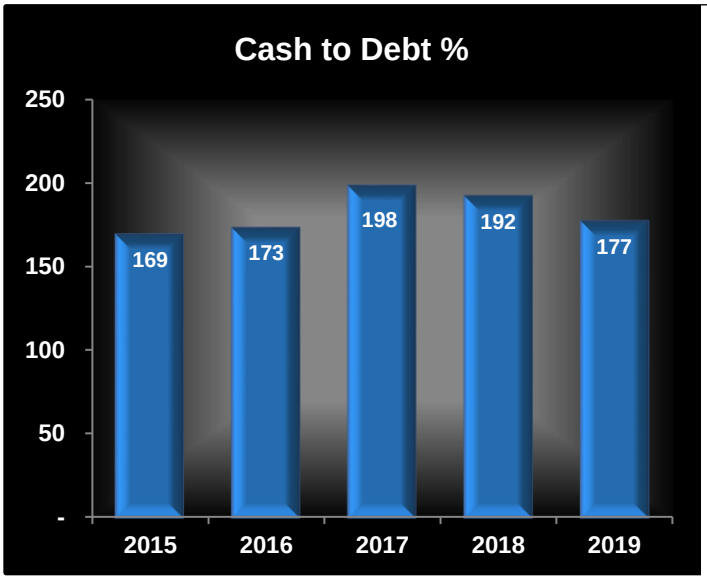
Outstanding long-term debt (including current portion) for the System as of June 30, 2019 and December 31, 2018 consist of the following:

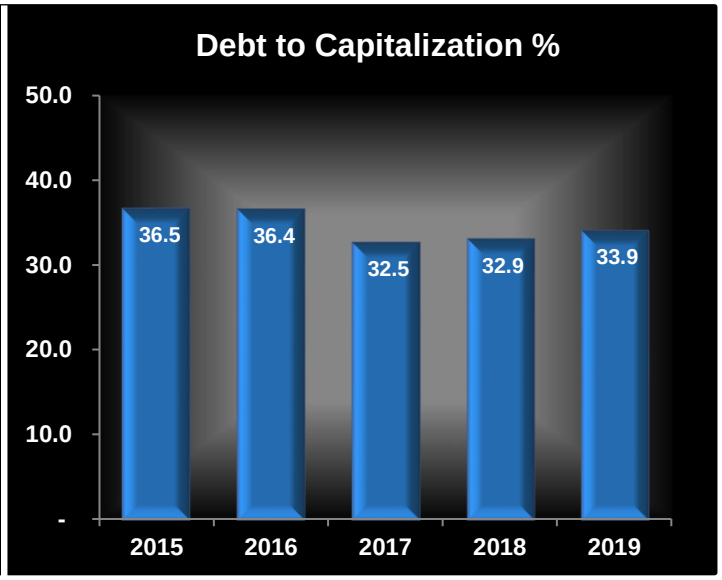
**Hospital Revenue Bonds and Notes**
**(Dollars in thousands)**

| Series | Type | Final Maturity | June 30 2019 | December 31 2018 |
|---|---|---|---|---|
| 2019A Revenue Bonds | Fixed | 2068 | $ 247,045 | $ - |
| 2019B Revenue Bonds | Fixed | 2068 | 250,320 | - |
| 2019C Revenue Bonds | Floating | 2068 | 89,000 | - |
| 2019D Revenue Bonds | Variable | 2068 | 119,340 | - |
| 2019E Revenue Bonds | Variable | 2068 | 130,405 | - |
| 2019F Revenue Bonds | Variable | 2068 | 130,405 | - |
| 2018 Sterling Notes[1] | Fixed | 2068 | 508,168 | 509,476 |
| 2017A Revenue Bonds | Fixed | 2043 | 812,205 | 818,775 |
| 2017B Revenue Bonds | Fixed | 2043 | 167,580 | 169,255 |
| 2017C Revenue Bonds | Fixed | 2032 | 8,555 | 8,945 |
| 2016 Private Placement | Fixed | 2046 | 325,000 | 325,000 |
| 2016 Term Loan | Variable | 2026 | 15,170 | 15,170 |
| 2014 Taxable Bonds | Fixed | 2114 | 400,000 | 400,000 |
| 2014A CP Notes | CP | 2044 | - | 70,955 |
| 2013A Revenue Bonds | Fixed | 2042 | 62,650 | 62,650 |
| 2013B Revenue Bonds | Variable | 2039 | 201,160 | 201,160 |
| 2013 Keep Memory Alive Bonds | Variable | 2037 | 59,115 | 59,115 |
| 2012A Revenue Bonds | Fixed | 2039 | 430,710 | 439,925 |
| 2011A Revenue Bonds | Fixed | 2032 | 136,120 | 148,645 |
| 2011B Revenue Bonds | Fixed | 2031 | 24,900 | 26,380 |
| 2011C Revenue Bonds | Fixed | 2032 | 144,035 | 157,945 |
| 2009B Revenue Bonds | Fixed | 2039 | - | 16,135 |
| 2008B Revenue Bonds | Variable | 2043 | 327,575 | 327,575 |
| 2003C Revenue Bonds | Variable | 2035 | 41,905 | 41,905 |
| 2010 Martin Bonds | Fixed | 2035 | 17,220 | - |
| 2013 Martin Bonds | Variable | 2035 | 17,880 | - |
| 2018 Martin Taxable Loan | Variable | 2035 | 20,812 | - |
| Revolving Credit Facility | Variable | 2019 | - | 105,000 |
| Notes Payable | Varies | Varies | 3,876 | 106 |
| Finance leases | Varies | Varies | 119,111 | 121,589 |
| | | | $ 4,810,262 | $ 4,025,706 |

[1]Converted to U.S. dollars using foreign exchange rates at the period end date

The following charts summarize cash-to-debt and debt-to-capitalization ratios for the System at December 31 for the last four years and at June 30, 2019:




## BOND RATINGS

The obligated group's outstanding bonds have been assigned ratings of Aa2 (stable outlook) and AA (stable outlook) by Moody's and S&P, respectively. In April 2019, Moody's and S&P affirmed their respective ratings and outlooks. According to reports issued by Moody's and S&P, the ratings reflect a unique and strong enterprise profile, a strong leadership team and a national and international clinical reputation.

The following table lists the various bond rating categories for Moody's and S&P:

**Bond Ratings**

| | Rating category | | |
|---|---|---|---|
| | Moody's | S&P | Definition |
| Strongest | Aaa | AAA | Prime |
| ↕ | Aa | AA | High grade/high quality |
| ↕ | A | A | Upper medium grade |
| ↕ | Baa | BBB | Lower medium grade |
| ↕ | Ba | BB | Non-investment grade/speculative |
| ↕ | B | B | Highly speculative |
| ↕ | Caa/Ca | CCC | Extremely speculative |
| Weakest | C | D | Default or bankruptcy |
| Cleveland Clinic | Aa2 | AA | |

Within each rating category are the following modifiers
Moody's ratings: 1 indicates higher end, 2 indicates mid-range, 3 indicates lower end
S&P ratings: + indicates higher end, - indicates lower end

Based on recent ratings summary reports obtained from Moody's and S&P, no healthcare organizations were rated in the prime category.

## CONSOLIDATED RESULTS OF OPERATIONS

### For the Quarters Ended June 30, 2019 and 2018

The following narrative describes the consolidated results of operations for the System for the second quarters of 2019 and 2018. The consolidated results of operations for the second quarter of 2019 includes the financial operations of Martin Health System and Indian River Hospital, which became consolidated entities of the System in January 2019. For comparative purposes, certain financial activity in the narrative below is presented on a same facility basis, which excludes the financial operations of Martin Health System and Indian River Hospital for the second quarter of 2019.

Operating income for the System in the second quarter of 2019 was $116.2 million, resulting in an operating margin of 4.4%, as compared to operating income of $25.1 million and an operating margin of 1.1% in the second quarter of 2018. On a same facility basis (excluding

Martin Health System operating loss of $7.3 million and Indian River Hospital operating income of $0.7 million), operating income for the Health System was $122.8 million, resulting in an operating margin of 5.1%. The higher operating income on a same facility basis resulted from a 9.6% increase in unrestricted revenues driven by higher patient volumes that outpaced total unrestricted expense growth of 5.2% in the same period. Nonoperating gains for the System were $110.3 million in the second quarter of 2019 compared to nonoperating gains of $55.6 million in the second quarter of 2018. The increase from the prior year was primarily due to favorable changes in the financial markets. Overall, the System reported an excess of revenues over expenses of $226.5 million in the second quarter of 2019 compared to an excess of revenues over expenses of $80.7 million in the second quarter of 2018.

The System's net patient service revenue increased $408.3 million (20.5%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, net patient service revenue increased $181.5 million (9.1%). Patient volumes on a same facility basis were higher than the second quarter of 2018. The System experienced a 4.8% increase in same facility inpatient acute admissions, a 6.0% increase in same facility total surgical cases and a 6.9% increase in same facility outpatient evaluation and management visits. The System has experienced a reduction in acute average length of stay in the second quarter of 2019, which has created additional capacity to help meet the demand of higher patient volumes. Net patient revenue has also benefited from rate increases on the System's managed care contracts that became effective in 2019. In the second quarter of 2019, the System recorded an increase of $40.2 million in net patient service revenue for changes in estimated transaction prices related to prior years. Offsetting the favorable trends in net patient service revenue is a shift in the gross revenue payor mix that has negatively impacted the revenue realization of the System. The System has experienced an increase in Medicare revenue primarily as a result of demographic trends in the service area and other industry trends. On a combined basis including Martin Health System and Indian River Hospital, governmental and self-pay revenue as a percentage of total gross patient revenue has increased 1.2% in the second quarter of 2019 compared to the same period in 2018. The System has experienced a corresponding decrease in managed care and commercial gross revenues as a percentage of total gross patient revenues. Over the last few years, the System has initiated national, regional and local revenue management projects designed to improve patient care access throughout the System.

Other unrestricted revenues increased $35.9 million (16.3%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, other unrestricted revenues increased $29.5 million (13.4%). The increase in other unrestricted revenues was primarily due to a $14.0 million increase in outpatient pharmacy revenue, a $7.9 million increase in management service revenues and a $6.0 million increase in revenue associated with research projects. These increases were offset by a $6.1 million decrease in gifts and assets released from restriction primarily due to the shift in the timing of an annual philanthropy event from the second quarter of 2018 to the first quarter of 2019.

Total operating expenses increased $353.1 million (16.2%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, total operating expenses increased $113.4 million (5.2%). Notable increases in expenses were primarily driven by higher patient volumes and were experienced in salaries, wages and benefits, supplies expenses and pharmaceutical costs. The System has

implemented Care Resource Optimization initiatives to address the growth in expenses caused by inflationary pressures in many expense categories such as salaries, benefits and specialized pharmaceuticals. Care Resource Optimization initiatives are designed to transform patient care and business models in an effort to provide quality, affordable patient care. The System identifies, quantifies and implements these initiatives through an extensive analysis of the cost structure. The System continues to develop and implement cost management and containment plans designed to make a more affordable care model for patients and to enable investments in key strategic initiatives.

Salaries, wages and benefits increased $205.1 million (16.7%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, salaries, wages and benefits increased $68.3 million (5.6%). Same facility salaries, excluding benefits, increased $57.5 million (5.5%) due to annual salary adjustments averaging 2-3% across the System that were awarded in the second quarter of 2019 and a 2.0% increase in average full-time equivalent employees in the second quarter of 2019 compared to the same period in 2018. Benefit costs increased $10.8 million (6.3%) during the same period. The System experienced a $3.6 million increase in FICA expenses and a $2.6 million increase in defined contribution expenses primarily due to the increase in salaries and full-time equivalent employees.

Supplies expense increased $42.9 million (20.1%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, supplies expense increased $10.0 million (4.7%). The increase in same facility supplies was comprised of a $15.5 million increase in implantables and other medical supplies primarily due to increased patient volumes offset by a $5.5 million decrease in non-medical supplies primarily due to the shift in the timing of an annual philanthropy event from the second quarter of 2018 to the first quarter of 2019.

Pharmaceutical costs increased $49.1 million (18.0%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, pharmaceutical costs increased $33.5 million (12.3%). The increase in same facility pharmaceutical costs is primarily due to higher costs and increased utilization in the oncology departments. In addition, the System operates a specialty pharmacy that is used to treat chronic illnesses and complex conditions. Specialty pharmacy expenses increased $11.7 million in the second quarter of 2019 compared to the same period in 2018. The System has also experienced a corresponding increase in outpatient pharmacy revenues related to specialty pharmaceuticals.

Purchased services and other fees increased $10.8 million (7.6%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, purchased services and other fees decreased $8.0 million (5.6%). The decrease in same facility purchased services and other fees was primarily related to a $6.5 million reduction in deferred tax liabilities and a $1.2 million decrease in external lab costs.

Administrative services increased $0.3 million (0.5%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, administrative services decreased $5.8 million (10.4%). The decrease in same facility administrative services was primarily due to a $6.9 million decrease is consulting and special project fees for various System strategic initiatives and a $0.2 million decrease in expenses related to research projects.

Facilities expense increased $4.9 million (5.5%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, facilities expense decreased $3.0 million (3.4%).

The decrease in same facility expenses was primarily due to a $1.3 million decrease in repairs and maintenance expenses, a $0.6 million decrease in rent expenses and a $0.4 million decrease in utility costs.

Insurance expense increased $2.4 million (10.6%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, insurance expense decreased $2.4 million (10.5%). The decrease in same facility insurance expense was primarily due to an insurance settlement accrual recorded in the second quarter of 2018.

Interest expense increased $5.0 million (14.4%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, interest expense increased $1.9 million (5.5%). The increase in same facility interest expense is primarily due to the issuance of bonds in the second quarter of 2019 and the issuance of the 2018 Sterling Notes in the third and fourth quarters of 2018. Please refer to "FINANCING DEVELOPMENTS" for a description of the debt issued in 2018 and 2019.

Depreciation and amortization expenses increased $33.6 million (26.8%) in the second quarter of 2019 compared to the same period in 2018. On a same facility basis, depreciation expense increased $19.8 million (15.8%). Changes in depreciation include property, plant and equipment that was fully depreciated in 2018, offset by depreciation for property, plant and equipment that was acquired and placed into service after the second quarter of 2018. Depreciation expense in the second quarter of 2019 includes an $11.6 million loss related to a reduction in the value of property that was reclassified from held and used to assets held for sale.

Gains and losses from nonoperating activities are recorded below operating income in the statement of operations. These items resulted in a net gain to the System of $110.3 million in the second quarter of 2019 compared to a net gain of $55.6 million in the second quarter of 2018, resulting in a favorable variance of $54.7 million. Investment returns were favorable by $182.5 million in the second quarter of 2019 compared to the same period in 2018. The System's long-term investment portfolio reported investment gains of 2.0% for the second quarter of 2019, which is higher than 0.2% of investment losses experienced in the second quarter of 2018. Derivative gains and losses were unfavorable by $39.5 million in the second quarter of 2019 compared to the same period in 2018. Derivative gains and losses result from changes in the interest rate benchmark associated with the System's foreign exchange forward currency contracts and interest rate swap agreements, including net interest paid or received under the swap agreements. Other nonoperating gains and losses were unfavorable by $88.3 million in the second quarter of 2019 compared to the same period in 2018. Other nonoperating gains and losses in 2019 include a $17.3 million loss on extinguishment of debt related to the defeasance of bonds previously held by Martin Health System. Other nonoperating gains and losses in 2018 include a $52.3 million member substitution contribution related to the acquisition of Union Hospital.

## For the Six Months Ended June 30, 2019 and 2018

The following narrative describes the consolidated results of operations for the System for the first six months of 2019 and 2018.

The consolidated results of operations for the first six months of 2019 includes the financial operations of Martin Health System and Indian

River Hospital, which became consolidated entities of the System in January 2019. For comparative purposes, certain financial activity in the narrative below is presented on a same facility basis, which excludes the financial operations of Martin Health System and Indian River Hospital for the first six months of 2019.

Union Hospital joined the Health System in April 2018. For the first six months of 2019, Union Hospital comprised approximately 1.2% of total consolidated operating revenues and 1.4% of total consolidated operating expenses. No adjustments have been made in the following narrative to exclude Union Hospital operations except where indicated for comparative purposes.

Operating income for the System in the first six months of 2019 was $152.4 million, resulting in an operating margin of 2.9%, as compared to operating income of $72.7 million and an operating margin of 1.7% in the first six months of 2018. On a same facility basis (excluding Martin Health System operating loss of $3.4 million and Indian River Hospital operating income of $3.2 million), operating income for the Health System was $152.6 million, resulting in an operating margin of 3.2%. The higher operating income on a same facility basis resulted from an 8.4% increase in unrestricted revenues that outpaced total unrestricted expense growth of 6.7% in the same period. Nonoperating gains for the System were $993.5 million in the first six months of 2019 compared to nonoperating gains of $114.5 million in the first six months of 2018. The increase from the prior year was primarily due to member substitution contributions from Martin Health System and Indian River Hospital as well as favorable changes in the financial markets. Overall, the System reported an excess of revenues over expenses of $1,146 million in the first six months of 2019 compared to an excess of revenues over expenses of $187.2 million in the first six months of 2018.

The System's net patient service revenue increased $781.4 million (20.1%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, net patient service revenue increased $316.5 million (8.1%). Patient volumes on a same facility basis and excluding Union Hospital in the first six months of 2019 were higher than the first six months of 2018. The System experienced a 3.7% increase in same facility inpatient acute admissions, a 5.3% increase in same facility total surgical cases and a 6.1% increase in same facility outpatient evaluation and management visits. The System has experienced a reduction in acute average length of stay in the first six months of 2019, which has created additional capacity to help meet the demand of higher patient volumes. Net patient revenue has also benefited from rate increases on the System's managed care contracts that became effective in 2019. In the second quarter of 2019, the System recorded an increase of $40.2 million in net patient service revenue for changes in estimated transaction prices related to prior years. Offsetting the favorable trends in net patient service revenue is a shift in the gross revenue payor mix that has negatively impacted the revenue realization of the System. The System has experienced an increase in Medicare revenue primarily as a result of demographic trends in the service area and other industry trends. On a combined basis including Martin Health System and Indian River Hospital, governmental and self-pay revenue as a percentage of total gross patient revenue has increased 0.9% in the first six months of 2019 compared to the same period in 2018. The System has experienced a corresponding decrease in managed care and commercial gross revenues as a percentage of total gross patient revenues. Over the last few years, the System has initiated national, regional and local revenue management projects designed to improve patient care access throughout the System.

Other unrestricted revenues increased $62.7 million (14.5%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, other unrestricted revenues increased $48.6 million (11.2%). The increase in other unrestricted revenues was primarily due to a $24.7 million increase in outpatient pharmacy revenue and a $7.5 million increase in management service revenues.

Total operating expenses increased $764.4 million (18.0%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, total operating expenses increased $285.3 million (6.7%). Notable increases in expenses were primarily driven by higher patient volumes and were experienced in salaries, wages and benefits, supplies expenses and pharmaceutical costs. The System has implemented Care Resource Optimization initiatives to address the growth in expenses caused by inflationary pressures in many expense categories such as salaries, benefits and specialized pharmaceuticals. Care Resource Optimization initiatives are designed to transform patient care and business models in an effort to provide quality, affordable patient care. The System identifies, quantifies and implements these initiatives through an extensive analysis of the cost structure. The System continues to develop and implement cost management and containment plans designed to make a more affordable care model for patients and to enable investments in key strategic initiatives.

Salaries, wages and benefits increased $433.0 million (18.0%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, salaries, wages and benefits increased $161.7 million (6.7%). Same facility salaries, excluding benefits, increased $142.8 million (6.9%) due to annual salary adjustments averaging 2-3% across the System that were awarded in the second quarter of 2019 and a 2.9% increase in average full-time equivalent employees in the first six months of 2019 compared to the same period in 2018. Same facility benefit costs increased $18.9 million (5.4%) during the same period. The System experienced a $9.3 million increase in FICA expenses and a $4.3 million increase in defined contribution expenses primarily due to the increase in salaries and full-time equivalent employees.

Supplies expense increased $88.9 million (21.3%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, supplies expense increased $22.9 million (5.5%). The increase in same facility supplies was comprised of a $14.3 million increase in implantables and an $8.6 million increase in other medical supplies primarily due to increased patient volumes.

Pharmaceutical costs increased $96.8 million (18.4%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, pharmaceutical costs increased $67.3 million (12.8%). The increase in same facility pharmaceutical costs is primarily due to higher costs and increased utilization in the oncology departments. In addition, the System operates a specialty pharmacy that is used to treat chronic illnesses and complex conditions. Specialty pharmacy expenses increased $19.7 million in the first six months of 2019 compared to the same period in 2018. The System has also experienced a corresponding increase in outpatient pharmacy revenues related to specialty pharmaceuticals.

Purchased services and other fees increased $47.2 million (17.4%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, purchased services and other fees increased $9.0 million (3.3%). The increase in same facility purchased services and other fees was primarily related to a $3.4 million increase in software and hardware technology

costs primarily related to maintenance agreements, current period software subscriptions and repair services, a $4.4 million increase in state franchise fee expenses and other various costs associated with certain System projects and initiatives. These increases were offset by a $6.5 million reduction in deferred tax liabilities.

Administrative services increased $9.5 million (9.9%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, administrative services decreased $0.9 million (0.9%). The decrease in same facility administrative services was primarily due to a $3.3 million decrease in consulting and special project fees for various System strategic initiatives.

Facilities expense increased $15.5 million (8.9%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, facilities expense decreased $2.0 million (1.1%). The decrease in same facility expenses was primarily due to a reduction in repairs and maintenance costs.

Insurance expense increased $7.7 million (18.3%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, insurance expense in the first six months of 2019 decreased $2.3 million (5.5%). The decrease in same facility insurance expense was primarily due to an insurance settlement accrual recorded in 2018.

Interest expense increased $11.7 million (17.4%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, interest expense increased $4.9 million (7.2%). The increase in same facility interest expense is primarily due to the issuance of bonds in the second quarter of 2019 and the issuance of the 2018 Sterling Notes in the third and fourth quarters of 2018. Please refer to "FINANCING DEVELOPMENTS" for a description of the debt issued in 2018 and 2019.

Depreciation and amortization expenses increased $55.8 million (22.1%) in the first six months of 2019 compared to the same period in 2018. On a same facility basis, depreciation expense increased $26.5 million (10.5%). Changes in depreciation include property, plant and equipment that was fully depreciated in 2018, offset by depreciation for property, plant and equipment that was acquired and placed into service after the first six months of 2018. Depreciation expense in the second quarter of 2019 includes an $11.6 million loss related to a reduction in the value of property that was reclassified from held and used to assets held for sale.

Gains and losses from nonoperating activities are recorded below operating income in the statement of operations. These items resulted in a net gain to the System of $993.5 million in the first six months of 2019 compared to a net gain of $114.5 million in the first six months of 2018, resulting in a favorable variance of $879.0 million. Investment returns were favorable by $517.1 million in the first six months of 2019 compared to the same period in 2018. The System's long-term investment portfolio reported investment gains of 7.4% for the first six months of 2019, which is higher than investment gains of 0.2% experienced in the first six months of 2018. Derivative gains and losses were unfavorable by $63.4 million in the first six months of 2019 compared to the same period in 2018. Derivative gains and losses result from changes in the interest rate benchmark associated with the System's foreign exchange forward currency contracts and interest rate swap agreements, including net interest paid or received under the swap agreements. Other nonoperating gains and losses were favorable by $425.3 million in the first six months of 2019 compared to the same period in 2018. Other nonoperating gains and

losses in 2019 include a $501.7 million member substitution contribution related to the acquisitions of Martin Health System and Indian River Hospital offset by a $17.3 million loss on extinguishment of debt related to the defeasance of bonds previously held by Martin Health System. Other nonoperating gains and losses in 2018 include a $52.3 million member substitution contribution related to the acquisition of Union Hospital.

## BALANCE SHEET – JUNE 30, 2019 COMPARED TO DECEMBER 31, 2018

The following narrative describes the consolidated balance sheets for the System as of June 30, 2019 and December 31, 2018. The consolidated balance sheets at June 30, 2019 includes Martin Health System and Indian River Hospital, which became consolidated entities of the System in January 2019. For comparative purposes, certain financial activity in the narrative below is also presented on a same facility basis, which excludes balance sheet information of Martin Health System and Indian River Hospital as of June 30, 2019.

Cash and cash equivalents increased $65.4 million (14.7%) from December 31, 2018 to June 30, 2019. On a same facility basis, cash and cash equivalents increased $32.0 million (7.2%). The majority of the System's cash and cash equivalents are held in operating bank accounts for general expenditures.

Patient accounts receivable increased $153.4 million (13.7%) from December 31, 2018 to June 30, 2019. On a same facility basis, patient receivables increased $41.0 million (3.6%).The increase in same facility patient receivables is partially due to an increase in net patient service revenue resulting from increased levels of patient activity and rate increases on the System's managed care contracts that became effective in January 2019. The System has also experienced an increase in patient responsibility accounts receivable. Patient responsibility accounts represent the portion of services that is not paid by a patient's insurance company, typically in the form of co-pays and deductibles. Patient responsibility accounts receivable tend to be seasonally higher in the first quarter as many insurance plans have annual deductible requirements. These balances are generally more difficult to collect than traditional insurance payors. The System has various initiatives to enhance cash collection efforts and create efficiencies in the revenue cycle process, including the implementation of Enterprise Administrative Patient Management (EAPM), a project that consolidated billing, collections and other revenue cycle support services into one technology platform. EAPM was implemented at the Weston facilities and the Clinic in 2012 and 2016, respectively, and at the System's Ohio regional hospitals excluding Union Hospital at various phases throughout 2017 and 2018. Days revenue outstanding for the System decreased from 49 days at December 31, 2018 to 48 days at June 30, 2019.

Other current assets increased $108.8 million (25.5%) from December 31, 2018 to June 30, 2019. On a same facility basis, other current assets increased $74.2 million (17.4%). The increase in same facility other current assets was primarily due to a $24.3 million increase in management fee receivables, a $19.8 million increase in prepaid expenses driven by annual maintenance and information technology contracts and a reclassification of assets from property, plant and equipment to assets held for sale. These increases were offset by a $9.2 million reduction in receivables related to research projects. There was also a

corresponding reduction in research deferred revenue.

Unrestricted long-term investments increased $738.6 million (9.8%) from December 31, 2018 to June 30, 2019. On a same facility basis, unrestricted long-term investments increased $559.5 million (7.4%). The increase in same facility long-term investments was primarily due to $553.3 million of unrestricted investment income experienced in the System's investment portfolio, which experienced gains of 7.4% in the first six months of 2019.

Funds held by trustees increased $183.0 million (370.6%) from December 31, 2018 to June 30, 2019. On a same facility basis, funds held by trustee increased $182.9 million (370.4%). The increase in same facility funds held by trustees is primarily due to a balance of $162.8 million in unexpended bond proceeds from the bonds issued in 2019 that will be used to reimburse the System for construction projects and a $19.3 million increase in collateral posted with the counterparties on the System's derivative contracts.

Assets held for self-insurance increased $49.6 million (46.4%) from December 31, 2018 to June 30, 2019. On a same facility basis, assets held for self-insurance increased $43.7 million (40.9%). The increase in same facility self-insurance assets is primarily due to premiums received by the captive insurance subsidiary in excess of claims paid and positive investment returns in the System's captive insurance investment portfolio.

Donor restricted assets increased $63.3 million (8.5%) from December 31, 2018 to June 30, 2019. On a same facility basis, donor restricted investments increased $37.5 million (5.0%). The increase in same facility donor restricted assets was primarily from investment income on restricted investments and the receipt of donor restricted gifts in excess of expenditures from restricted funds.

Net property, plant and equipment increased $708.8 million (14.0%) from December 31, 2018 to June 30, 2019. On a same facility basis, property, plant and equipment increased $94.9 million (1.9%). The System had same facility net expenditures for property, plant and equipment of $494.3 million, offset by depreciation expense of $279.0 million that includes an $11.6 million loss related to property that was reclassified from held and used to assets held for resale. The System also had proceeds from the sale of property, plant and equipment of $59.7 million and foreign currency translation losses of $1.6 million. Capital expenditures in 2019 include amounts paid on retainage liabilities recorded at December 31, 2018 and exclude assets acquired through finance leases and other financing arrangements. Retainage liabilities decreased $35.2 million, and new capital leases totaled $9.4 million. Expenditures for property, plant and equipment were incurred at numerous facilities across the System and include expenditures for strategic construction, expansion and technological investment as well as replacement of existing facilities and equipment. For a description of a few of System's current projects, refer to "EXPANSION AND IMPROVEMENT PROJECTS."

Other noncurrent assets increased $344.4 million (52.8%) from December 31, 2018 to June 30, 2019. On a same facility basis, other noncurrent assets increased $215.4 million (33.0%). The increase in same facility noncurrent assets was primarily due to the adoption of accounting standard update 2016-02 *Leases*, which resulted in a $216.1 million right-of-use asset representing the present value of remaining lease payments for operating leases.

Accounts payable decreased $81.8 million (15.5%) from December 31, 2018 to June 30,

2019. On a same facility basis, accounts payable decreased $110.4 million (20.9%). The decrease in same facility accounts payable was primarily attributable to the timing of payment processing for trade payables, a $35.2 million decrease in retainage liabilities on current construction projects and a $3.4 million increase in outstanding checks.

Compensation and amounts withheld from payroll increased $90.9 million (25.3%) from December 31, 2018 to June 30, 2019. On a same facility basis, compensation and amounts withheld from payroll increased $57.0 million (15.9%).The change was primarily attributable to the timing of payroll and the growth in employee benefit accruals.

Current portion of long-term debt decreased $96.4 million (50.4%) from December 31, 2018 to June 30, 2019. On a same facility basis, current portion of long-term debt decreased $101.2 million (52.9%). The decrease was primarily due to the payment of $105.0 million on the System's revolving credit facility, which was terminated in 2019. Changes in the same facility current portion of long-term debt also include the reclassification of regularly scheduled principal payments from long-term to current that are due within one year, offset by principal payments made in 2019.

Variable rate debt classified as current increased $123.8 million (30.4%) from December 31, 2018 to June 30, 2019. On a same facility basis, variable rate debt classified as current increased $123.8 million (30.4%). Long-term debt classified as current consists of variable-rate bonds supported by the System's self-liquidity program and bonds with letters of credit or standby bond purchase agreements that expire within one year, require repayment of a remarketing draw within one year or contain a subjective clause that would allow the lender to declare an event of default and cause immediate repayment of such bonds. The increase in variable rate debt classified as current is due to the reclassification of $75.4 million of debt from long-term to current for bonds supported by a standby bond purchase agreement that expires within one year and a net increase of $48.4 million in self-liquidity bonds, comprised of the Series 2019D Bonds issued in 2019 for $119.3 million offset by a payment on the Series 2014A Bonds for $71.0 million.

Other current liabilities increased $31.1 million (6.3%) from December 31, 2018 to June 30, 2019. On a same facility basis, other current liabilities increased $4.7 million (1.0%). Increases in in same facility other current liabilities include a $23.5 million increase in the current portion operating lease liabilities resulting from the adoption of accounting standard update 2016-02 *Leases*, and a $5.2 million increase in current portion of derivative liabilities associated with forward currency forward contracts. Decreases in same facility other current liabilities include a $21.1 million decrease in state franchise fee liabilities primarily related to the timing of payments to the State of Ohio and a $9.2 million decrease in deferred revenue related to research projects.

Long-term debt increased $772.5 million (21.7%) from December 31, 2018 to June 30, 2019. On a same facility basis, long-term debt increased $427.1 million (12.0%). The increase in same facility long-term debt is primarily due to the issuance of bonds in 2019 offset by the reclassification of regularly scheduled principal payments from long-term to current for debt payments due within one year and the reclassification of debt from long-term to current for bonds supported by a standby bond purchase agreement that expires within one year.

Professional and general insurance liability reserves increased $50.0 million (35.4%) from December 31, 2018 to June 30, 2019. On a same facility basis, professional and general insurance

liability reserves increased $36.7 million (26.0%). The increase in same facility insurance liability reserves is due to the increase in reserves at the System's captive insurance subsidiary related to the addition of Martin Health System and Indian River Hospital to the System's captive insurance program as well as expenses recorded for the accrual of current year claim estimates in excess of claim liability payments.

Accrued retirement benefits increased $41.7 million (9.0%) from December 31, 2018 to June 30, 2019. On a same facility basis, accrued retirement benefits decreased $12.1 million (2.6%). The decrease in same facility accrued retirement benefits is comprised of a $9.7 million decrease in the System's defined benefit pension plan liabilities and a $2.5 million decrease in other postretirement benefit liabilities. The decrease in defined benefit pension plan liabilities was primarily due to net periodic benefit, which is resulting from the expected return on plan assets in excess of interest cost incurred on plan obligations.

Other noncurrent liabilities increased $186.6 million (34.4%) from December 31, 2018 to June 30, 2019. On a same facility basis, other noncurrent liabilities increased $140.9 million (26.0%). The increase in same facility other noncurrent liabilities is primarily due to the adoption of accounting standard update 2016-02 *Leases*, which resulted in a $172.1 million lease obligation representing the present value of remaining lease payments for operating leases. This increase was offset by a $6.5 million reduction in deferred tax liabilities.

Total net assets increased $1,297 million (13.6%) from December 31, 2018 to June 30, 2019. Net assets without donor restrictions increased $1,184 million (14.0%) primarily due to an excess of revenues over expenses of $1,146 million and net assets released from restriction for capital purposes of $39.6 million. Net assets with donor restrictions increased $112.9 million (10.7%), primarily due to a $69.7 million member substitution contribution, $59.8 million of donor restricted gifts and $42.3 million of restricted investment income. These increases were offset by $60.7 million in net assets released from restriction.

**Cleveland Clinic's Critical Care Transport (CCT) team**

## FORWARD-LOOKING STATEMENTS

Forward-looking statements contained in this report and other written reports and oral statements are made based on known events and circumstances at the time of release, and as such, are subject in the future to unforeseen uncertainties and risks. All statements regarding future performance, events or developments are forward-looking statements. It is possible that the System's future performance may differ materially from current expectations depending on economic conditions within the healthcare industry and other factors. Among other factors that might affect future performance are:

- Changes to the Medicare and Medicaid reimbursement systems resulting in reductions in payments and/or changes in eligibility of patients to qualify for Medicare and Medicaid;
- Legislative reforms or actions that reduce the payment for, and/or utilization of, healthcare services, such as the Patient Protection and Affordable Care Act and/or draft legislation to address reimbursement cuts related to the Sustainable Growth Rate Formulas;
- Possible repeal and/or replacement of the Patient Protection and Affordable Care Act, and repeal of the individual mandate;
- Adjustments resulting from Medicare and Medicaid reimbursement audits, including audits initiated by the Medicare Recovery Audit Contractor program;
- Future contract negotiations between public and private insurers, employers and participating hospitals, including the System's hospitals, and other efforts by these insurers and employers to limit hospitalization costs and coverage;
- Increased competition in the areas served by the System and limited options to respond to the same in part due to uncertainty in the enforcement of antitrust laws;
- The ability of the System to integrate the hospitals in Florida into a regional health system;
- The ability of the System to access capital for the funding of capital projects;
- Availability of malpractice insurance at reasonable rates, if at all;
- The System's ability to recruit and retain professionals;
- The ability of the Clinic to develop the London Hospital and establish relationships with payors in that market;
- General economic and business conditions, internationally, nationally and regionally, including the impact of interest rates, foreign currencies, financial market conditions and volatility and increases in the number of self-pay patients;
- The increasing number and severity of cyber threats and the costs of preventing them and protecting patient and other data;
- The declining population in the Greater Cleveland area;
- Impact of federal and state laws on tax-exempt organizations relating to exemption from income taxes, sales taxes, real estate taxes, excise taxes and bond financing, including the Tax Cuts and Jobs Act;
- Management, utilization and increases in the cost of medical drugs and devices as technological advancement progresses without concurrent increases in federal reimbursement;
- Ability of the System to adjust its cost structure and reduce operating expenses; and
- Changes in accounting standards or practices.

The System undertakes no obligation to update or publicly revise these forward-looking statements to reflect events or circumstances that arise after the date of this report.