

In the opinion of Bond Counsel, under existing statutes, regulations, published rulings and court decisions, assuming continuous compliance by the Issuer, Baylor Scott & White Holdings and certain affiliates after the date of initial delivery of the Series 2016A Bonds with certain covenants contained in the Bond Indenture and the Loan Agreement and subject to the matters described in "TAX EXEMPTION" herein, interest on the Series 2016A Bonds (i) will be excludable from the gross income of the owners thereof for federal income tax purposes and (ii) will not be included in computing the federal alternative minimum taxable income of the owners thereof who are individuals or, except as described herein, corporations. See "TAX EXEMPTION" herein for a discussion of Bond Counsel's opinion, including a description of federal alternative minimum tax consequences for corporations.

\$373,340,000

**TARRANT COUNTY CULTURAL EDUCATION
FACILITIES FINANCE CORPORATION
Hospital Revenue Bonds
(Baylor Scott & White Health Project)
Series 2016A**

Dated: Date of Delivery**Due: As stated below****INTEREST:**

Interest on the Series 2016A Bonds will be payable on May 15 and November 15, commencing November 15, 2016, and calculated on the basis of a 360-day year of twelve 30-day months.

DENOMINATIONS:

The Series 2016A Bonds are issuable in denominations of \$5,000 or any integral multiple of \$5,000.

PURPOSE:

The Series 2016A Bonds are being issued to finance and refinance the costs of constructing and equipping health facilities for Baylor Scott & White Holdings, a Texas nonprofit corporation ("*BSW Holdings*"), and affiliates including refunding prior to their maturity all of the outstanding Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds (Scott & White Healthcare Project) Series 2010 (the "*Series 2010 Bonds*"), and finance a portion of the cost of issuance with respect to the Series 2016A Bonds.

REDEMPTION:

The Series 2016A Bonds are subject to redemption or purchase at the option of BSW Holdings, on or after May 15, 2026, and sooner under extraordinary circumstances, as described herein. See "**THE SERIES 2016A BONDS-Redemption and Purchase Provisions**" herein.

LIMITED OBLIGATIONS:

The Series 2016A Bonds are limited obligations of the Issuer, payable solely from loan payments to be made or guaranteed by BSW Holdings and certain affiliates as well as funds held under the Bond Indenture.

MATURITY SCHEDULE

**\$200,725,000
SERIAL BONDS**

| Maturity November 15, | Principal Amount | Interest Rate | Yield | CUSIP* | Maturity November 15, | Principal Amount | Interest Rate | Yield | CUSIP* |
|--------------------------|---------------------|------------------|--------|-----------|--------------------------|---------------------|------------------|---------|-----------|
| 2016 | \$ 3,500,000 | 3.000% | 0.600% | 87638QNS4 | 2027 | \$ 2,240,000 | 5.000% | 2.190%† | 87638QPD5 |
| 2017 | 4,605,000 | 4.000 | 0.740 | 87638QNT2 | 2028 | 25,150,000 | 5.000 | 2.270† | 87638QPE3 |
| 2018 | 4,835,000 | 4.000 | 0.850 | 87638QNU9 | 2029 | 30,665,000 | 5.000 | 2.340† | 87638QPF0 |
| 2019 | 5,095,000 | 5.000 | 1.000 | 87638QNV7 | 2030 | 9,765,000 | 5.000 | 2.390† | 87638QPG8 |
| 2020 | 5,150,000 | 5.000 | 1.130 | 87638QNW5 | 2031 | 10,515,000 | 5.000 | 2.470† | 87638QPH6 |
| 2021 | 700,000 | 3.000 | 1.330 | 87638QNX3 | 2032 | 11,220,000 | 5.000 | 2.530† | 87638QPJ2 |
| 2022 | 730,000 | 5.000 | 1.480 | 87638QNY1 | 2033 | 18,230,000 | 3.000 | 3.070 | 87638QPK9 |
| 2023 | 765,000 | 4.000 | 1.660 | 87638QNZ8 | 2034 | 18,195,000 | 4.000 | 3.050† | 87638QPL7 |
| 2024 | 795,000 | 4.000 | 1.840 | 87638QPA1 | 2035 | 15,305,000 | 4.000 | 3.110† | 87638QPM5 |
| 2025 | 830,000 | 5.000 | 1.990 | 87638QPB9 | 2036 | 15,605,000 | 4.000 | 3.160† | 87638QPN3 |
| 2026 | 875,000 | 5.000 | 2.130† | 87638QPC7 | 2037 | 15,955,000 | 5.000 | 2.810† | 87638QPP6 |

\$77,050,000 4.000% Term Bond due November 15, 2042; Priced at 105.340% to yield 3.370%†; CUSIP No. 87638QPR4*

\$95,565,000 5.000% Term Bond due November 15, 2045; Priced at 117.272% to yield 3.000%†; CUSIP No. 87638QPP8*

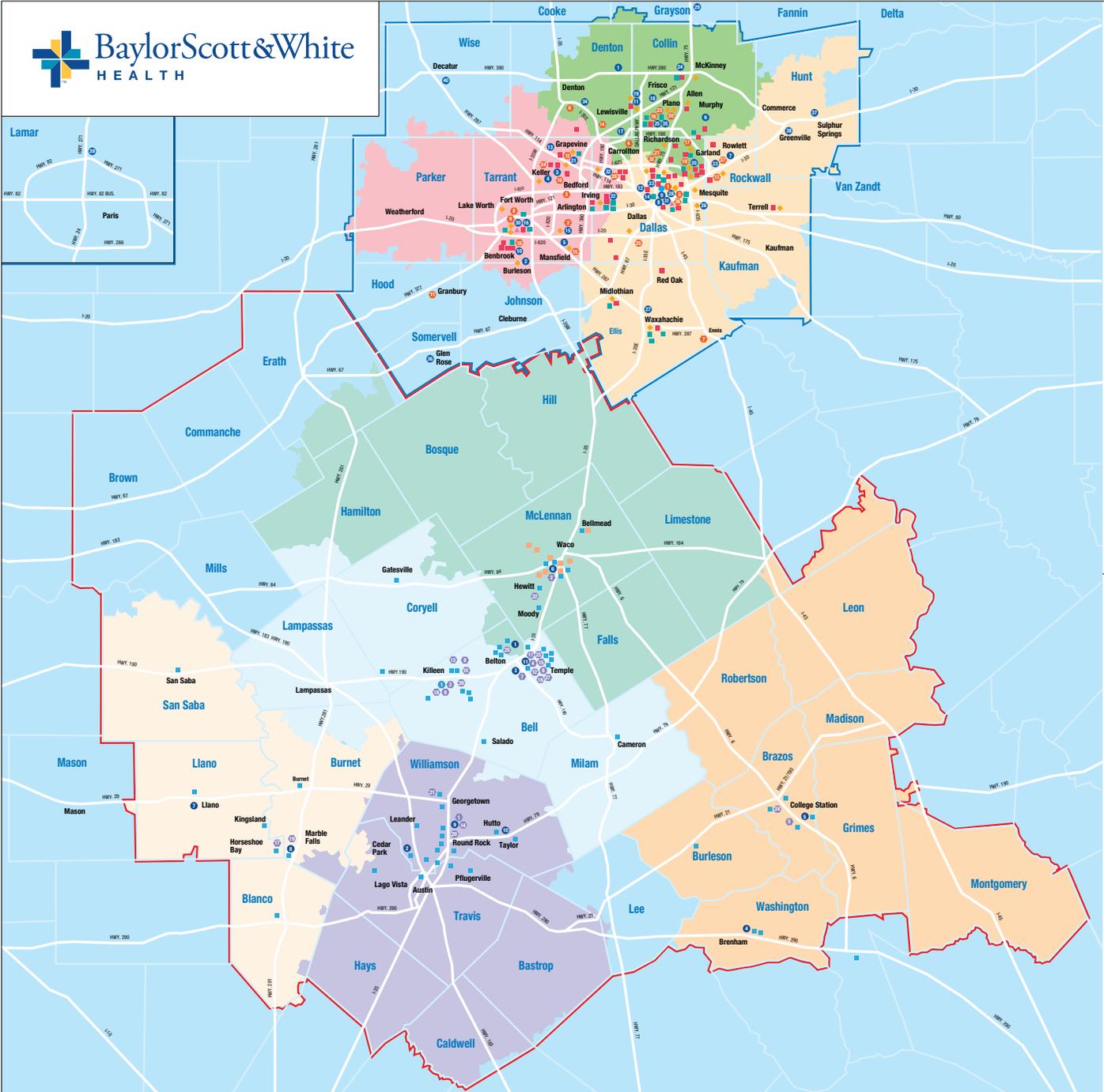
† Yield to May 15, 2026, the first optional redemption date excluding extraordinary optional redemption.

Neither the State of Texas nor any political subdivision or agency, including Tarrant County, Texas, is obligated to pay the Series 2016A Bonds. Neither the faith and credit nor the taxing power of the State of Texas, Tarrant County, Texas, or any other political subdivision or agency is or will be pledged to the payment to the Series 2016A Bonds. The Issuer has no taxing power.

The Series 2016A Bonds are offered when, as, and if all the Series 2016A Bonds are simultaneously issued and accepted by the Underwriters, subject to prior sale, to withdrawal or modification of the offer without notice, and to the approval of certain legal matters by the Attorney General of the State of Texas and an opinion as to legality by Norton Rose Fulbright US LLP, Bond Counsel. Certain legal matters are subject to the approval of Norton Rose Fulbright US LLP, counsel to BSW Holdings and the other Obligated Affiliates described herein; Brown Pruitt Wambsganss Ferrill & Dean, P.C., counsel to the Issuer; Nathan Sommers Jacobs, a Professional Corporation, counsel to the Master Trustee and the Bond Trustee; and Bracewell LLP, counsel to the Underwriters. Series 2016A Bonds in book-entry form are expected to be available for credit through the facilities of DTC on or about April 19, 2016.

CITIGROUP**J.P. MORGAN****ESTRADA HINOJOSA & COMPANY, INC.****SIEBERT BRANDFORD SHANK & CO., L.L.C.**

The date of this Official Statement is April 6, 2016



North Texas Division

Hospitals

- 1 Baylor Emergency Medical Center at Aubrey¹
- 2 Baylor Emergency Medical Center at Burleson¹
- 3 Baylor Emergency Medical Center at Colleyville¹
- 4 Baylor Emergency Medical Center at Keller¹
- 5 Baylor Emergency Medical Center at Mansfield¹
- 6 Baylor Emergency Medical Center at Murphy¹
- 7 Baylor Emergency Medical Center at Rockwall¹
- 8 Baylor Jack and Jane Hamilton Heart and Vascular Hospital¹
- 9 Baylor Institute for Rehabilitation¹
- 10 Baylor Institute for Rehabilitation at Fort Worth¹
- 11 Baylor Institute for Rehabilitation at Frisco¹
- 12 Baylor Institute for Rehabilitation at North West Dallas¹
- 13 Baylor Medical Center at Trinity Club¹
- 14 Baylor Medical Center at Uptown¹
- 15 Baylor Orthopedic and Spine Hospital at Arlington¹
- 16 Baylor Scott & White All Saints Medical Center-Fort Worth¹
- 17 Baylor Scott & White Medical Center-Carrollton¹
- 18 Baylor Scott & White Medical Center-CenterStreet¹
- 19 Baylor Scott & White Medical Center-Frisco¹
- 20 Baylor Scott & White Medical Center-Garland¹
- 21 Baylor Scott & White Medical Center-Grapewine¹
- 22 Baylor Scott & White Medical Center-Irving¹
- 23 Baylor Scott & White Medical Center-Lake Pointe¹
- 24 Baylor Scott & White Medical Center-McKinney¹
- 25 Baylor Scott & White Medical Center-Plano¹
- 26 Baylor Scott & White Medical Center-Sunnyvale¹
- 27 Baylor Scott & White Medical Center-Waxahachie¹
- 28 Baylor Scott & White Medical Center-White Rock¹
- 29 Baylor Scott & White Surgical Hospital-Sherman¹
- 30 Baylor Surgical Hospital at Fort Worth¹
- 31 Baylor University Medical Center at Dallas¹
- 32 Irving-Coppell Surgical Hospital¹
- 33 North Central Surgical Center¹
- 34 The Heart Hospital Baylor Denton¹
- 35 The Heart Hospital Baylor Plano¹

Ambulatory Surgical Centers

- 1 Baylor Ambulatory Endoscopy Center¹
- 2 Baylor Surgicare at Arlington¹
- 3 Baylor Surgicare at Bedford¹
- 4 Baylor Surgicare at Carrollton¹
- 5 Baylor Surgicare at Dallas¹
- 6 Baylor Surgicare at Denton¹
- 7 Baylor Surgicare at Ermine¹
- 8 Baylor Surgicare at Fort Worth I¹
- 9 Baylor Surgicare at Fort Worth II¹
- 10 Baylor Surgicare at Garland¹
- 11 Baylor Surgicare at Grapewine¹
- 12 Baylor Surgicare at Grapevine¹
- 13 Baylor Surgicare at Heath¹
- 14 Baylor Surgicare at Lewisville¹
- 15 Baylor Surgicare at Mansfield¹
- 16 Baylor Surgicare at Northeast Fort Worth¹
- 17 Baylor Surgicare at North Garland¹
- 18 Baylor Surgicare at Oremont¹
- 19 Baylor Surgicare at Plano¹
- 20 Baylor Surgicare at Plano Parkway¹
- 21 Baylor Surgicare at Richardson¹
- 22 Baylor Surgicare at Valley View¹
- 23 Day Surgery Center of North Texas¹
- 24 Lonestar Endoscopy¹
- 25 North Texas Surgery Center¹
- 26 Physicians DaySurgery Center¹
- 27 Rockwell Surgery Center¹
- 28 Tuscan Center¹

Research

- 1 Baylor Scott & White Research Institute

Medical Offices and Centers

- 1 Fitness Centers
- 2 Outpatient Rehabilitation Services
- 3 Primary Care Centers
- 4 Specialty Practice

Legend

- 1 Owned/operated hospitals
- 2 Joint ventured hospitals
- 3 Joint ventured surgery centers
- 4 Affiliated hospitals

North Texas Market Regions

- Central
- East
- West

Central Texas Division

Hospitals

- 1 Baylor Scott & White Continuing Care Hospital-Temple
- 2 Baylor Scott & White Emergency Medical Center-Cedar Park
- 3 Baylor Scott & White McLaren Children's Medical Center
- 4 Baylor Scott & White Medical Center-Brenham
- 5 Baylor Scott & White Medical Center-College Station
- 6 Baylor Scott & White Medical Center-Hillcrest (Waco)
- 7 Baylor Scott & White Medical Center-Llano
- 8 Baylor Scott & White Medical Center-Martine Falls
- 9 Baylor Scott & White Medical Center-Round Rock
- 10 Baylor Scott & White Medical Center-Taylor
- 11 Scott & White Medical Center-Temple
- 12 Scott & White Specialty Clinic-Horseshoe Bay
- 13 Scott & White Specialty Clinic-Killeen Hemingway
- 14 Scott & White Specialty Clinic-Martine Falls
- 15 Scott & White Specialty Clinic-Round Rock
- 16 Scott & White Sports Medicine & Rehabilitation Clinic-Georgetown
- 17 Scott & White Sports Therapy & Rehabilitation Clinic-Hewitt
- 18 Scott & White Surgery Center-Temple
- 19 Scott & White Today Care-College Station
- 20 Scott & White Urgent Care Clinic-Ballton
- 21 Scott & White Urgent Care Clinic-Killeen
- 22 Scott & White Vascular Cancer Treatment Center-Temple

Partnered/Contracted Hospitals

- 1 Moxiplex Health System-Killeen

Outpatient Services

- 1 Baylor Scott & White Cancer Center-Round Rock
- 2 Baylor Scott & White McCann Cancer Center-Waco
- 3 Scott & White Cancer Center-Killeen
- 4 Scott & White Center for Diagnostic Medicine
- 5 Scott & White Cosmetic Surgery Center-College Station
- 6 Scott & White Cosmetic Surgery Center-Temple
- 7 Scott & White Clinic and Dialysis Center-Temple South Loop
- 8 Scott & White Dialysis Center-Killeen
- 9 Scott & White Dialysis Center-Killeen West
- 10 Scott & White Eye Clinic-Harker Heights
- 11 Scott & White Eye Institute
- 12 Scott & White Mental Health Center-Temple
- 13 Scott & White Mental Health Clinic-Killeen
- 14 Scott & White Nephrology & Dialysis Center-Round Rock
- 15 Scott & White Ronny Bone & Joint Institute
- 16 Scott & White Sleep Institute

Primary Care Clinics

- 1 Hillcrest Family Health Center Clinics
- 2 Scott & White Clinics

Central Texas Market Regions

- Austin/Round Rock
- College Station
- Hill Country
- Temple
- Waco

No dealer, salesman or any other person has been authorized by the Issuer, BSW Holdings, the other Obligated Affiliates described herein or the Underwriters to give any information or to make any representation other than those contained in this Official Statement and the Appendices hereto in connection with the offering described herein and, if given or made, such other information or representation must not be relied upon. This Official Statement does not constitute an offer to sell the Series 2016A Bonds or a solicitation of an offer to buy, nor shall there be any sale of the Series 2016A Bonds, by any person in any state or other jurisdiction to any person to whom it is unlawful to make such offer, solicitation or sale.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the Series 2016A Bonds, or determined that this Official Statement is accurate or complete. Any representation to the contrary is a criminal offense.

The information set forth herein under the captions “**THE ISSUER**” and “**LITIGATION AND PROCEEDINGS — The Issuer**” has been furnished by the Issuer. The information set forth herein under the caption “**BOOK-ENTRY SYSTEM**” has been furnished by The Depository Trust Company (“**DTC**”). The information supplied by each Underwriter is limited to the information relating to it contained under the caption “**UNDERWRITING**” and the initial pricing information for the Series 2016A Bonds on the cover of this Official Statement. All other information contained in this Official Statement has been obtained from BSW Holdings and other sources believed to be reliable. Such other information is not guaranteed as to accuracy or completeness by, and is not to be relied upon as, or construed as a promise or representation by, the Underwriters or any other person. In accordance with their responsibilities under the federal securities laws, the Underwriters have reviewed the information in this Official Statement but do not guarantee its accuracy or completeness. This Official Statement is submitted in connection with the sale of securities referred to herein and may not be used, in whole or in part, for any other purpose. The information and expressions of opinion set forth herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of the Issuer, DTC, BSW Holdings, any other Obligated Affiliate or any other person since the date of the information set forth herein. This Official Statement does not constitute a contract among or between the Issuer, BSW Holdings, any other Obligated Affiliate or the Underwriters and any purchaser of the Series 2016A Bonds.

The Bank of New York Mellon Trust Company, National Association, in each of its capacities, including but not limited to Bond Trustee, Master Trustee and bond registrar, has not participated in the preparation of this Official Statement and assumes no responsibility for its content.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER, BSW HOLDINGS, THE OTHER OBLIGATED AFFILIATES AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS. THE SERIES 2016A BONDS HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION (THE “**SEC**”) UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THE REGISTRATION, QUALIFICATION OR EXEMPTION OF THE SERIES 2016A BONDS IN ACCORDANCE WITH THE APPLICABLE SECURITIES LAW PROVISIONS OF THE JURISDICTIONS IN WHICH THESE SECURITIES HAVE BEEN REGISTERED, QUALIFIED OR EXEMPTED SHOULD NOT BE REGARDED AS A RECOMMENDATION THEREOF. NEITHER THESE JURISDICTIONS NOR ANY OF THEIR AGENCIES HAVE GUARANTEED OR PASSED UPON THE SAFETY OF THE SERIES 2016A BONDS AS AN INVESTMENT, UPON THE PROBABILITY OF ANY EARNINGS THEREON OR UPON THE ACCURACY OR ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2016A BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE SERIES 2016A BONDS TO CERTAIN DEALERS AT PRICES LOWER THAN THE OFFERING PRICES STATED ON THE COVER PAGE HEREOF, AND SAID OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS WITHOUT NOTICE.

The cover page contains certain information for general reference only and is not intended as a summary of this offering. Investors should read this entire Official Statement, including all attached appendices, to obtain information essential to making an informed investment decision. **APPENDIX C** contains definitions of certain capitalized terms used in this Official Statement. There are risks associated with the purchase of the Series 2016A Bonds. For a discussion of certain of these risks, see “**BONDHOLDERS’ RISKS**” herein.

This Official Statement, including **APPENDIX A** hereto, contains “forward-looking statements,” which generally can be identified with words or phrases such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “foresees,” “may,” “plan,” “predict,” “should,” “will” or other words or phrases of similar import. All statements included in this Official Statement that any person expects or anticipates will, should or may occur in the future are forward-looking statements. These statements are based on assumptions and analyses made by BSW Holdings in light of its experience and perception of historical trends, current conditions and expected future developments as well as other factors it believes are appropriate in the circumstances. However, whether actual results and developments conform with expectations and predictions is subject to a number of risks and uncertainties, including, without limitation, the information discussed under “**BONDHOLDERS’ RISKS**” in this Official Statement as well as additional factors beyond BSW Holdings’ control. The important risk factors and assumptions described under that caption and elsewhere herein could cause actual results to differ materially from those expressed in any forward-looking statement. All of the forward-looking statements made in this Official Statement are qualified by these cautionary statements. There can be no assurance that the actual results or developments anticipated will be realized or, even if substantially realized, that they will have the expected consequences to or effects on BSW Holdings’ business or operations. All subsequent forward-looking statements attributable to BSW Holdings or persons acting on its behalf are expressly qualified in their entirety by the factors and assumptions described above and in any documents containing those forward-looking statements. No person has any obligation to prepare or release any updates or revisions to any forward-looking statement.

CUSIP® is a registered trademark of the American Bankers Association. CUSIP data herein are provided by CUSIP Global Services, managed by Standard & Poor’s Capital IQ. CUSIP numbers have been assigned by an independent company not affiliated with the Issuer, the Underwriters or BSW Holdings and are included solely for the convenience of the holders of the Series 2016A Bonds. Neither the Issuer nor the Underwriters nor BSW Holdings is responsible for the selection or use of these CUSIP numbers, and no representation is made as to their correctness on the Series 2016A Bonds or as indicated above. The CUSIP number for a specific maturity is subject to being changed after the execution and delivery of the Series 2016A Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of the Series 2016A Bonds.

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OFFICIAL STATEMENT

\$373,340,000

**Tarrant County Cultural Education Facilities Finance Corporation
Hospital Revenue Bonds
(Baylor Scott & White Health Project)
Series 2016A**

INTRODUCTORY STATEMENT

This Official Statement is furnished in connection with the offering by the Tarrant County Cultural Education Facilities Finance Corporation (the “*Issuer*”) of its Hospital Revenue Bonds (Baylor Scott & White Health Project) Series 2016A (the “*Series 2016A Bonds*”) in the aggregate principal amount of \$373,340,000.

The Issuer is a nonprofit corporation organized with the approval of the Commissioners Court of Tarrant County, Texas, with full power and authority to issue the Series 2016A Bonds pursuant to the Cultural Education Facilities Finance Corporation Act, Article 1528m, Vernon’s Annotated Texas Civil Statutes, as amended (the “*Act*”).

The proceeds of the Series 2016A Bonds will be loaned to Baylor Scott & White Holdings, a Texas nonprofit corporation (“*BSW Holdings*”), and will be used to (i) refund prior to their maturity the Issuer’s outstanding Hospital Revenue Bonds (Scott & White Healthcare Project) Series 2010 (the “*Series 2010 Bonds*”), (ii) finance and refinance the cost of developing, constructing, and equipping certain health facilities consisting of the Series 2016 Project described below under the subcaption “—**The Series 2016 Project**,” and (iii) pay a portion of the cost of issuance of the Series 2016A Bonds. See “**PLAN OF FINANCING**” herein.

The Series 2016A Bonds will be issued pursuant to the provisions of an Indenture of Trust and Security Agreement, dated as of April 1, 2016 (the “*Bond Indenture*”), between the Issuer and The Bank of New York Mellon Trust Company, National Association, as trustee (the “*Bond Trustee*”). The Issuer will loan the proceeds of the Series 2016A Bonds to BSW Holdings pursuant to a Loan Agreement, dated as of April 1, 2016 (the “*Loan Agreement*”), between the Issuer and BSW Holdings. Under the Loan Agreement, BSW Holdings will agree to make payments at such times and in such amounts as shall be sufficient to pay principal of, premium, if any, and interest on the Series 2016A Bonds when and as due.

Simultaneously with the issuance of the Series 2016A Bonds, and to evidence BSW Holdings’ obligation to repay amounts pursuant to the Loan Agreement with respect to the Series 2016A Bonds, BSW Holdings will execute and deliver a promissory note (the “*Series 2016A Note*”) to the Issuer. The Series 2016A Note and certain of the Issuer’s rights under the Loan Agreement will be assigned to the Bond Trustee under the Bond Indenture for the equal and ratable benefit of the owners of the Series 2016A Bonds. The Series 2016A Note will be in the same principal amount as the Series 2016A Bonds and will have terms and conditions requiring payments thereon sufficient to pay all amounts to become due on the Series 2016A Bonds.

The Series 2016A Note will be entitled to the benefits of a Master Indenture of Trust and Security Agreement dated as of February 1, 2014, as amended and supplemented (the “*Master Indenture*”), among BSW Holdings, Baylor Health Care System, a Texas nonprofit corporation (“*BHCS*”), Baylor University Medical Center, a Texas nonprofit corporation, Baylor All Saints Medical Center, a Texas nonprofit corporation, Baylor Regional Medical Center at Grapevine, a Texas nonprofit corporation, Baylor Medical Center at Waxahachie, a Texas nonprofit corporation, Baylor Regional Medical Center at Plano, a Texas nonprofit corporation, Scott & White Healthcare, a Texas nonprofit corporation (“*S&W*”), Scott & White Memorial Hospital, a Texas nonprofit corporation, Scott & White Clinic, a Texas nonprofit corporation, Scott & White Hospital – Round Rock, a Texas nonprofit corporation, Scott & White Continuing Care Hospital, a Texas nonprofit corporation, and Hillcrest Baptist Medical Center, a Texas nonprofit corporation (each, together with any successor corporation permitted under the Master Indenture or affiliate obligated under the Master Indenture hereafter, an “*Obligated Affiliate*”), and The Bank of New York Mellon Trust Company, National Association, as trustee (the “*Master Trustee*”).

Effective on the date of issuance of the Series 2016A Bonds, Baylor Scott & White Health, a Texas nonprofit corporation (“*BSW Health*”), Baylor Medical Centers at Garland and McKinney, and Scott & White Hospital – College Station (collectively, the “*New Obligated Affiliates*”) will each become Obligated Affiliates pursuant to that certain Fourth Supplement to Master Indenture of Trust and Security Agreement dated as of the date of issuance of the Series 2016A Bonds (the “*Fourth Supplement*”). At the time the Series 2016A Bonds are issued, BSW Holdings, BSW Health, BHCS, S&W, Baylor University Medical Center, Baylor All Saints Medical Center, Scott & White Memorial Hospital, Baylor Regional Medical Center at Grapevine, Baylor Medical Center at Waxahachie, Baylor Regional Medical Center at Plano, Baylor Medical Centers at Garland and McKinney, a Texas nonprofit corporation, Scott & White Clinic, Scott & White Hospital – Round Rock, Scott & White Continuing Care Hospital, Scott & White Hospital – College Station, a Texas nonprofit corporation, and Hillcrest Baptist Medical Center will be the only Obligated Affiliates under the Master Indenture. The Obligated Affiliates, together with any other entity that becomes an Obligated Affiliate under the Master Indenture in the future, jointly and severally guarantee the payment of each promissory note, including the Series 2016A Note, and certain other obligations entitled to the benefits of the Master Indenture (together with the Series 2016A Note, the “*Master Debt*”) and agree to maintain certain operating and financial covenants relating to their ability to pay such Master Debt. See “**SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2016A BONDS—The Master Indenture**” herein.

The Master Indenture permits other Persons to become Obligated Affiliates, as well as the release of an Obligated Affiliate, upon compliance with certain requirements set forth in the Master Indenture. The Master Indenture also permits the issuance of other obligations as Master Debt under the Master Indenture, and the replacement of the Master Indenture and the obligors on the Series 2016A Note, upon compliance with certain requirements. See “**SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2016A BONDS — The Master Indenture**” and “**THE MASTER INDENTURE — Concerning the Obligated Affiliates,**” “**— Issuance of Master Debt Under the Master Indenture**” and “**— Replacement Master Indenture**” in APPENDIX C.

The descriptions and summaries of various documents hereinafter set forth do not purport to be comprehensive or definitive, and reference is made to each document for the complete details of all terms and conditions thereof. All statements herein regarding any such document are qualified in their entirety by reference to such document. See APPENDIX C for definitions of certain words and terms used herein.

THE ISSUER

The Issuer is a Texas nonstock, nonprofit cultural educational facilities finance corporation established for the purposes set forth in the Act. The Issuer was incorporated pursuant to the Act in March 2003 with the approval of Tarrant County, Texas (the “*County*”). The Act grants to the Issuer the same powers, authority and rights with respect to health facilities that a health facilities development corporation has with respect to health facilities described in the Health Facilities Development Act, Chapter 221, Texas Health and Safety Code, as amended (the “*Health Act*”). The Issuer is authorized to provide, expand and improve health facilities (as defined in the Health Act) determined by the Issuer to be needed for the purpose of improving the adequacy, cost and accessibility of health care, research and education within the State of Texas.

The Issuer is governed by a board of directors, consisting of six members (with two vacancies) appointed by the Commissioners Court of the County. The board of directors of the Issuer adopted a bond resolution on March 17, 2016, authorizing the issuance of the Series 2016A Bonds.

Under the terms of the Act and the Health Act, the Issuer has, among other powers, the power to make contracts and incur liabilities; to borrow money at such rates of interest as it may determine; to issue its bonds in accordance with the provisions of the Act and the Health Act; and to secure any of its bonds or obligations by mortgage or pledge of all or any of its property, franchises and income for the purpose of financing or refinancing all or a portion of the cost of any health facility (as defined in the Health Act).

The directors of the Issuer are not personally liable in any way for any act or omission committed or suffered in the performance of the functions of the Issuer.

Neither the Issuer nor the County has assumed any responsibility for the matters contained herein except, in the case of the Issuer, solely as to matters relating to the Issuer. All findings and determinations by the Issuer and the County, respectively, are and have been made by each for its own internal uses and purposes. Notwithstanding its approval of the Series 2016A Bonds for purposes of Section 147(f) of the Internal Revenue Code of 1986, as amended (the “*Code*”), the County does not endorse or in any manner, directly or indirectly, guarantee or promise to pay the Series 2016A Bonds from any source of funds of the County or guarantee, warrant or endorse the creditworthiness or credit standing of BSW Holdings or the other Obligated Affiliates, or in any manner guarantee, warrant, or endorse the investment quality or value of the Series 2016A Bonds. The Series 2016A Bonds are payable solely as described in this Official Statement or in the other applicable offering documents relating to the Series 2016A Bonds and are not in any manner payable wholly or partially from any funds or properties otherwise belonging to the Issuer. By its issuance of the Series 2016A Bonds, the Issuer does not in any manner, directly or indirectly, guarantee, warrant or endorse the creditworthiness of or the investment quality or value of the Series 2016A Bonds. The Issuer has no taxing power.

BAYLOR SCOTT & WHITE HEALTH

BSW Holdings is a Texas nonprofit corporation that was incorporated in June 2013 and is exempt from federal income taxation under Section 501(a) of the Code by virtue of being an entity described in Section 501(c)(3) of the Code.

BSW Holdings and its affiliates (collectively, the “*System*”) operate the largest not-for-profit healthcare system in Texas and one of the largest in the United States as measured by total operating revenue of \$7.5 billion and \$4 billion for the fiscal year ended June 30, 2015 and for the 6-month period ended December 31, 2015, respectively, and total assets of \$9.7 billion and \$9.9 billion at June 30, 2015 and December 31, 2015, respectively. The System was created from the combination of two Texas healthcare systems, BHCS and its affiliates (the “*North Texas Division*”) and S&W and its affiliates (the “*Central Texas Division*”). BSW Holdings and the System were created by BHCS and S&W in connection with their combination. BSW Holdings is the sole member of BHCS and S&W and has control and substantial reserved powers over all BHCS and S&W material affiliates.

Only BSW Holdings, BSW Health, BHCS, S&W, Baylor University Medical Center, Baylor All Saints Medical Center, Scott & White Memorial Hospital, Baylor Regional Medical Center at Grapevine, Baylor Medical Center at Waxahachie, Baylor Regional Medical Center at Plano, Baylor Medical Centers at Garland and McKinney, Scott & White Clinic, Scott & White Hospital – Round Rock, Scott & White Continuing Care Hospital, Scott & White Hospital – College Station and Hillcrest Baptist Medical Center and any future Obligated Affiliate under the Master Indenture have any liability with respect to payment of the principal of, premium, if any, or interest on the Series 2016A Bonds. No other affiliate or subsidiary of BSW Holdings has any liability with respect to the payment of the principal of, premium, if any, or interest on the Series 2016A Bonds. For the fiscal year ended June 30, 2015, the Obligated Affiliates, including the New Obligated Affiliates, accounted for 61.6% of the consolidated total operating revenue and 62.2% of the consolidated total operating expenses of the System. At June 30, 2015, the Obligated Affiliates, including the New Obligated Affiliates, accounted for 83.4% of the consolidated total assets of the System.

For additional information concerning BSW Holdings and its affiliates, see **APPENDIX A**. For the System’s audited combined financial statements for the year ended June 30, 2015 and the nine months ended June 30, 2014, see **APPENDIX B-1**. For the System’s unaudited interim combined financial statements for the six months ended December 31, 2015 and 2014, see **APPENDIX B-2**.

PLAN OF FINANCING

General

The proceeds of the Series 2016A Bonds will be loaned to BSW Holdings and will be used to (i) refund the Series 2010 Bonds currently outstanding in the aggregate principal amount of \$267,305,000, (ii) finance and refinance the cost of developing, constructing, and equipping certain health facilities consisting of the Series 2016

Project described below under the subcaption “—**The Series 2016 Project**,” and (iii) pay a portion of the cost of issuance of the Series 2016A Bonds

Prior to the issuance of the Series 2016A Bonds, BSW Holdings will issue its Taxable Bonds Series 2016 (the “**Taxable Bonds**”) in the estimated aggregate principal amount of \$534,785,000. The proceeds of the Taxable Bonds will be used to (i) finance and refinance the cost of developing, constructing and equipping certain health facilities to be owned and operated by BSW Holdings and certain of its affiliates, (ii) repay the amounts drawn under a Credit Agreement, dated as of February 22, 2016, between BSW Holdings and JPMorgan Chase Bank, National Association, an affiliate of one of the underwriters of the Taxable Bonds, (iii) pay costs of issuance of the Taxable Bonds and all or a portion of the cost of issuance of the Series 2016A Bonds, and (iv) provide funds for any eligible corporate purpose.

The application of the proceeds of the Series 2016A Bonds are reflected in “**ESTIMATED SOURCES AND USES**” herein.

The Series 2016 Project

BSW Holdings will use a portion of the proceeds of the Series 2016A Bonds to finance and refinance the cost of developing, constructing and equipping certain health facilities to be owned and operated by BSW Holdings and certain of its affiliates. It is contemplated that the proceeds will be used by (i) Baylor All Saints Medical Center for certain projects, including, but not limited to, expanding and renovating the emergency department, (ii) Baylor University Medical Center for certain projects, including, but not limited to, expanding and renovating perioperative services and space for additional critical care beds, and (iii) Scott & White Memorial Hospital for certain projects, including, but not limited to, constructing and equipping a surgical science building.

ESTIMATED SOURCES AND USES

The estimated sources and uses of funds for the plan of financing are as follows:

Sources of Funds:

| | <u>Total</u> |
|---------------------------------|-----------------------------|
| Bond Proceeds: | |
| Par Amount | \$373,340,000 |
| Net Premium | 51,548,395 |
| Funds held by 2010 Bond Trustee | 3,170 |
| Total Sources of Funds | <u><u>\$424,891,565</u></u> |

Uses of Funds:

| | |
|--------------------------------|-----------------------------|
| Refunding of Series 2010 Bonds | \$317,096,090 |
| Proceeds Fund | 106,004,989 |
| Cost of issuance | 1,790,486 |
| Total Uses of Funds | <u><u>\$424,891,565</u></u> |

The following table sets forth, for each fiscal year ended June 30, the estimated aggregate amounts required for the payment of principal at stated maturity or by mandatory sinking fund redemption prior to stated maturity of and interest on the Series 2016A Bonds and other outstanding debt of BSW Holdings and its affiliates after issuance of the Series 2016A Bonds. The table is based on the assumptions set forth in the footnotes on the following page. Actual interest rates on and amortizations of the outstanding debt of BSW Holdings and its affiliates that bear interest at a variable rate may vary from those assumed for this table. The following table does not take into account the net interest expense of the interest rate swaps to which BSW Holdings is a party that are secured as Master Debt

under the Master Indenture. See also **“BONDHOLDERS’ RISKS — The System’s Financial Obligations Could Increase or be Accelerated and Deplete its Available Funds”** and **“FINANCIAL INFORMATION — Debt and Capitalization”** and **“Interest Rate Swap Transactions”** in APPENDIX A hereto.

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PRO FORMA AGGREGATE ANNUAL DEBT SERVICE REQUIREMENTS

| Fiscal Year Ended June 30 | The Series 2016A Bonds ⁽¹⁾ | | The Taxable Bonds ⁽¹⁾ | | Other Master | Aggregate Master | Other System | Aggregate System |
|------------------------------|---------------------------------------|----------------------|----------------------------------|----------------------|-----------------------------------|------------------------|--------------------------------|------------------------|
| | Principal | Interest | Principal | Interest | Debt Service ⁽¹⁾⁽²⁾⁽³⁾ | Debt Service | Debt Service ⁽²⁾⁽⁴⁾ | Debt Service |
| 2016 | | | | | \$ 88,334,045 | \$ 88,334,045 | \$ 89,797,067 | \$178,131,111 |
| 2017 | \$ 3,500,000 | \$ 18,011,067 | | \$ 22,230,425 | 90,800,193 | 134,541,684 | 56,528,401 | 191,070,085 |
| 2018 | 4,605,000 | 16,649,750 | | 20,415,696 | 91,189,773 | 132,860,219 | 49,964,633 | 182,824,852 |
| 2019 | 4,835,000 | 16,460,950 | \$ 1,360,000 | 20,389,737 | 89,952,919 | 132,998,606 | 45,321,874 | 178,320,480 |
| 2020 | 5,095,000 | 16,236,875 | 8,670,000 | 20,198,287 | 84,569,407 | 134,769,568 | 43,548,731 | 178,318,299 |
| 2021 | 5,150,000 | 15,980,750 | 9,005,000 | 19,860,910 | 89,597,335 | 139,593,995 | 38,724,083 | 178,318,078 |
| 2022 | 700,000 | 15,841,500 | 9,355,000 | 19,510,459 | 97,659,626 | 143,066,585 | 35,249,445 | 178,316,030 |
| 2023 | 730,000 | 15,812,750 | 9,725,000 | 19,146,265 | 98,296,724 | 143,710,738 | 34,609,981 | 178,320,719 |
| 2024 | 765,000 | 15,779,200 | 10,100,000 | 18,767,850 | 97,953,868 | 143,365,918 | 34,950,616 | 178,316,534 |
| 2025 | 795,000 | 15,748,000 | 10,490,000 | 18,374,833 | 98,089,874 | 143,497,707 | 34,818,628 | 178,316,335 |
| 2026 | 830,000 | 15,711,350 | 10,905,000 | 17,966,450 | 99,374,331 | 144,787,131 | 33,533,262 | 178,320,393 |
| 2027 | 875,000 | 15,668,725 | 11,330,000 | 17,542,034 | 98,880,393 | 144,296,152 | 34,023,829 | 178,319,981 |
| 2028 | 2,240,000 | 15,590,850 | 11,770,000 | 17,101,106 | 108,550,240 | 155,252,196 | 23,067,814 | 178,320,010 |
| 2029 | 25,150,000 | 14,906,100 | 12,225,000 | 16,643,096 | 86,202,732 | 155,126,928 | 23,190,946 | 178,317,874 |
| 2030 | 30,665,000 | 13,510,725 | 12,700,000 | 16,167,333 | 83,648,343 | 156,691,401 | 21,626,821 | 178,318,222 |
| 2031 | 9,765,000 | 12,499,975 | 13,195,000 | 15,673,056 | 108,805,798 | 159,938,828 | 18,379,180 | 178,318,008 |
| 2032 | 10,515,000 | 11,992,975 | 13,710,000 | 15,159,499 | 110,519,038 | 161,896,512 | 16,423,823 | 178,320,335 |
| 2033 | 11,220,000 | 11,449,600 | 14,245,000 | 14,625,901 | 110,353,932 | 161,894,433 | 16,423,824 | 178,318,257 |
| 2034 | 18,230,000 | 10,895,650 | 14,795,000 | 14,071,593 | 106,957,926 | 164,950,168 | 13,366,824 | 178,316,992 |
| 2035 | 18,195,000 | 10,258,300 | 15,375,000 | 13,495,715 | 111,171,725 | 168,495,740 | 9,823,823 | 178,319,563 |
| 2036 | 15,305,000 | 9,588,300 | 15,970,000 | 12,897,409 | 114,733,854 | 168,494,563 | 9,823,823 | 178,318,386 |
| 2037 | 15,605,000 | 8,970,100 | 16,595,000 | 12,275,816 | 115,048,333 | 168,494,249 | 9,823,824 | 178,318,073 |
| 2038 | 15,955,000 | 8,259,125 | 17,240,000 | 11,629,982 | 115,412,796 | 168,496,903 | 9,823,823 | 178,320,726 |
| 2039 | 14,360,000 | 7,573,050 | 17,910,000 | 10,959,047 | 117,691,029 | 168,493,126 | 9,823,824 | 178,316,950 |
| 2040 | 14,530,000 | 6,995,250 | 18,610,000 | 10,261,962 | 118,098,472 | 168,495,684 | 9,823,824 | 178,319,508 |
| 2041 | 15,015,000 | 6,404,350 | 19,330,000 | 9,537,772 | 118,213,928 | 168,501,050 | 9,815,434 | 178,316,484 |
| 2042 | 15,555,000 | 5,792,950 | 20,080,000 | 8,785,524 | 118,288,187 | 168,501,661 | 9,815,435 | 178,317,096 |
| 2043 | 17,590,000 | 5,130,050 | 20,865,000 | 8,003,975 | 116,915,099 | 168,504,124 | 9,815,434 | 178,319,558 |
| 2044 | 20,915,000 | 4,255,375 | 21,680,000 | 7,191,886 | 114,461,941 | 168,504,202 | 9,815,435 | 178,319,637 |
| 2045 | 51,685,000 | 2,440,375 | 22,525,000 | 6,348,112 | 88,703,325 | 171,701,812 | 6,619,044 | 178,320,856 |
| 2046 | 22,965,000 | 574,125 | 23,400,000 | 5,471,507 | 125,908,143 | 178,318,774 | - | 178,318,774 |
| 2047 | | | 131,625,000 | 2,512,426 | 44,181,694 | 178,319,121 | - | 178,319,121 |
| 2048 | | | | | 22,623,317 | 22,623,317 | - | 22,623,317 |
| 2049 | | | | | 21,447,155 | 21,447,155 | - | 21,447,155 |
| 2050 | | | | | 21,575,415 | 21,575,415 | - | 21,575,415 |
| 2051 | | | | | 20,538,118 | 20,538,118 | - | 20,538,118 |
| TOTAL | \$373,340,000 | \$344,988,142 | \$534,785,000 | \$443,215,661 | \$3,344,749,030 | \$5,041,077,833 | \$768,373,504 | \$5,809,451,337 |

Footnotes on following page

Notes to Pro Forma Aggregate Annual Debt Service Requirements Table.

- (1) Master Debt under the Master Indenture. Amortization of the Series 2016A Bonds and certain other Master Debt is based on Master Indenture provisions for amortizing balloon maturities. Debt service on any relevant bullet maturities may change based on Master Indenture provisions for amortizing balloon maturities and market conditions. The actual maturities of the Series 2016A Bonds will include bullet maturities in one or more periods without any required sinking fund payments. If the System is unable to refinance such Master Debt, maximum annual debt service would increase and the extent of the increase could be substantial. See **“BONDHOLDERS’ RISKS — The System’s Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds.”**
- (2) Assumes an underlying variable rate assumption of the 20-year historical average through 12/31/2015 ranging between 2.72% and 2.82% for the respective underlying variable index for all debt listed under the heading “Long-Term Debt – Variable Rate” in the table titled **“System Debt and Capitalization”** in APPENDIX A hereto, which does not include remarketing agent and credit and liquidity provider fees, if any, but assumes that such debt will be continuously remarketed. If the assumed variable rates of interest increase, annual debt service would increase and the extent of the increase could be substantial. See **“BONDHOLDERS’ RISKS — The System’s Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds.”** Certain of the other Master Debt is subject to mandatory tender prior to its maturity. Debt service on such Master Debt has been calculated using the amortization schedules included in the related agreements or as provided in the Master Indenture. See **“FINANCIAL INFORMATION — Capital Leases”** and **“—Debt and Capitalization”** in APPENDIX A hereto. If the System is unable to refinance such Master Debt, maximum annual debt service would increase and the extent of the increase could be substantial. See **“BONDHOLDERS’ RISKS – The System’s Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds.”**
- (3) Includes all other outstanding Master Debt of the Obligated Affiliates, listed under the headings “Long-Term Debt – Fixed Rate” and “Long-Term Debt – Variable Rate” other than the “S&W Series 2010 Bonds” and “Bank Credit Agreement” in the table titled **“System Debt and Capitalization”** in APPENDIX A hereto. See **“FINANCIAL INFORMATION — Debt and Capitalization”** in APPENDIX A hereto. Debt service on any relevant bullet maturities may change based on Indenture provisions for amortizing balloon maturities and market conditions.
- (4) Includes all debt listed under the heading “Long-Term Debt – Other” in the table titled **“System Debt and Capitalization”** in APPENDIX A hereto. See **“FINANCIAL INFORMATION — Capital Leases”** and **“—Debt and Capitalization”** in APPENDIX A hereto.

THE SERIES 2016A BONDS

So long as DTC acts as a security depository for the Series 2016A Bonds, as described under “**BOOK-ENTRY SYSTEM**” herein, all references to “owner of the Series 2016A Bonds” or “Bondholder” are to Cede & Co., as nominee for The Depository Trust Company (“**DTC**”), and not to participants of DTC or Beneficial Owners.

General

The Series 2016A Bonds will mature on November 15 of the years and in the aggregate principal amounts set forth on the cover page of this Official Statement. The Series 2016A Bonds of each maturity will bear interest from and including their date of issuance and delivery to the Underwriters at the respective rates per annum set forth on the cover page of this Official Statement.

The Series 2016A Bonds will be issued in fully registered form only, without coupons, registered in the name of Cede & Co. in denominations of \$5,000 and integral multiples thereof.

The principal of and premium, if any, on the Series 2016A Bonds are payable to Cede & Co., as nominee for DTC, while it acts as securities depository for the Series 2016A Bonds. See “**BOOK-ENTRY SYSTEM**” below.

Interest on the Series 2016A Bonds will be payable to the holder thereof semiannually on May 15 and November 15 in each year commencing November 15, 2016 until the principal thereof is paid or duly provided for at or after the maturity thereof, and will be computed on the basis of a 360-day year of twelve 30-day months.

Redemption and Purchase Provisions

Optional Redemption. The Series 2016A Bonds are subject to redemption prior to their scheduled maturity at the option of BSW Holdings in whole or in part from time to time on any date, but in no event prior to May 15, 2026, at a price equal to 100% of the principal amount thereof plus accrued interest, if any, to the redemption date.

Extraordinary Optional Redemption. The Bond Trustee, on behalf of the Issuer, is required, upon BSW Holdings’ request given to the Issuer and the Bond Trustee not more than 365 days after the occurrence of an event described below, or, if later, the receipt by BSW Holdings of insurance proceeds or a condemnation award resulting from the occurrence of any event described in clauses (i) or (ii) below, to redeem all or any part of the outstanding Series 2016A Bonds specified by BSW Holdings prior to their stated maturities, at a price equal to the principal amount thereof together with interest, if any, accrued on such Series 2016A Bonds from the most recent interest payment date therefor to the redemption date (except as provided below), but without premium:

(i) *Damage or Destruction:* in whole or in part, if any property of the Combined Group has been damaged or destroyed to the extent that all proceeds of insurance upon any of the properties of the Combined Group plus all compensation for any such properties taken by eminent domain received by the Combined Group in such fiscal year exceed 5% of the book value (as of the close of the preceding fiscal year) or, at the option of BSW Holdings, 5% of the Current Value (as defined in the Master Indenture) of all tangible properties of the Combined Group, and if, in the reasonable judgment of BSW Holdings, (a) rebuilding, restoration or repair of a substantial portion of the properties of the Combined Group is required and either could not reasonably be expected to be completed within a period of six months or is not economically practicable or desirable or (b) the Combined Group is prevented or would likely be prevented from using a substantial portion of its properties for their normal purpose for a period of six months or more, or

(ii) *Eminent Domain:* in whole or in part, if title to any property of the Combined Group or the use or possession thereof has been taken or condemned by a competent authority from any public use or purpose to the extent that all compensation for any of such properties taken by eminent domain plus all proceeds of insurance upon any of the properties of the Combined Group received by the Combined Group in such fiscal year exceed 5% of the book value (as of the close of the preceding fiscal year) or, at the option of BSW Holdings, 5% of the Current Value of all tangible properties of the Combined Group, and if the Combined Group is prevented or, in the reasonable judgment of BSW Holdings, would likely be prevented from using a substantial portion of its properties for their normal purposes for a period of six months or more, or the repair, rebuilding, or restoration of a substantial portion of such property or the acquisition of other property of at least equal value and economic utility to that taken or condemned and

suitable for the proper and efficient operation of the properties of the Combined Group either could not reasonably be expected to be completed within a period of six months or is not economically practicable or desirable, or

(iii) *Change in Purpose:* in whole, if any member of the Combined Group is required or ordered, by legislative, judicial, or administrative action of the United States or of the State of Texas, or any agency, department, or subdivision thereof, to operate any of its facilities in a manner inconsistent with the stated goals, purposes, philosophies, and policies of BSW Holdings, including administering medical treatment and permitting surgical procedures, and such legislative, judicial, or administrative action is applicable to such member of the Combined Group because BSW Holdings is a party to a loan agreement or by any other reason relating to such member's being a party to a financing through the issuance of bonds by the Issuer.

Sinking Fund Redemption. The Issuer is required to redeem the Series 2016A Bonds maturing November 15, 2042, and November 15, 2045, on November 15 of the years and in the aggregate principal amounts shown below, at a redemption price equal to 100% of the principal amount thereof.

**Series 2016A Bonds due
November 15, 2042**

| <u>Year</u> | <u>Principal Amount</u> |
|-------------|-------------------------|
| 2038 | \$14,360,000 |
| 2039 | 14,530,000 |
| 2040 | 15,015,000 |
| 2041 | 15,555,000 |
| 2042 | 17,590,000* |

**Series 2016A Bonds due
November 15, 2045**

| <u>Year</u> | <u>Principal Amount</u> |
|-------------|-------------------------|
| 2043 | \$20,915,000 |
| 2044 | 51,685,000 |
| 2045 | 22,965,000* |

*Remaining due at stated maturity

The principal amount of the Series 2016A Bonds maturing November 15, 2042, and November 15, 2045, to be redeemed in any year will be reduced, upon request of BSW Holdings, by an amount equal to the principal amount of Series 2016A Bonds of such maturity surrendered by BSW Holdings to the Bond Trustee or selected for optional or extraordinary redemption in or prior to such year, if in either case such Series 2016A Bonds have not previously served as the basis for any such reduction.

Redemption Procedures. Notice of each redemption of Series 2016A Bonds is required to be mailed, first class postage pre-paid, not less than 20 days nor more than 60 days prior to the redemption date to DTC or, if it no longer acts as a securities depository, to each registered owner of Series 2016A Bonds to be redeemed at the address of such owner recorded in the bond register. If notice of redemption of any Series 2016A Bond is so given, such Series 2016A Bond will be due and payable on the redemption date (unless, in the case of an optional redemption, BSW Holdings revokes its option to redeem on or before such date) and, if funds sufficient and available to pay the redemption price therefor are deposited with the Bond Trustee on the redemption date, will cease to bear interest after such date. While the Series 2016A Bonds are registered in the name of DTC or its nominee, as nominee for the beneficial owners, the foregoing notice will be given to DTC or such nominee only, which will alone be responsible for providing such notice to the Beneficial Owners. See “**BOOK-ENTRY SYSTEM**” below. **BSW Holdings may, for any reason, revoke any exercise of its option to redeem Series 2016A Bonds on or before the redemption date.**

BSW Holdings may select the stated maturity, principal amount and interest rate of Series 2016A Bonds to be redeemed at its option. In the event of a redemption of less than all of the Series 2016A Bonds of any stated maturity and interest rate, the Series 2016A Bonds to be redeemed will be selected not more than 60 days prior to

the redemption date by the Bond Trustee from the Series 2016A Bonds of such stated maturity and interest rate which are then deemed outstanding and have not previously been called for redemption, by such method as the Bond Trustee deems fair and appropriate. The method of selection by the Bond Trustee may provide for the selection for redemption of portions (leaving unredeemed authorized denominations) of the principal of Series 2016A Bonds within a stated maturity (and bearing interest at the same rate) of a denomination larger than the smallest denomination authorized on the redemption date. If less than all of the Series 2016A Bonds of any stated maturity and interest rate registered in the name of DTC or any substitute securities depository or its nominee are selected for redemption, the securities depository or such nominee will determine the beneficial interests in such Series 2016A Bonds of such stated maturity and interest rate to be redeemed.

Purchase by BSW Holdings in Lieu of Redemption. When the Series 2016A Bonds may be redeemed by the Issuer at the option of BSW Holdings, BSW Holdings may elect to call the Series 2016A Bonds for purchase by BSW Holdings, in which case the Series 2016A Bonds may remain outstanding in accordance with their terms and be transferred to others. References to the “redemption” of Series 2016A Bonds herein include the call of Series 2016A Bonds for purchase by BSW Holdings.

Acceleration

If an Event of Default occurs and is continuing under the Bond Indenture, the Series 2016A Bonds may be declared immediately due and payable by the Bond Trustee. See “**THE BOND INDENTURE — Events of Default and Remedies**” in **APPENDIX C**.

A summary of certain provisions of the Series 2016A Bonds is contained herein under “**SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2016A BONDS.**” Reference is made to the Series 2016A Bonds for the complete text thereof and to the Bond Indenture for all of the provisions relating to the Series 2016A Bonds. The discussion herein is qualified by such reference. See **APPENDIX C** for definitions of certain words and terms used herein.

BOOK-ENTRY SYSTEM

The information in this section concerning DTC and the Book-Entry System has been obtained from DTC and is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Issuer, the Underwriters, the Bond Trustee, BSW Holdings, or the other Obligated Affiliates.

Series 2016A Bonds in Book-Entry Form. Beneficial ownership in the Series 2016A Bonds will be available to Beneficial Owners (as described below) only by or through DTC Participants via a book-entry system (the “**Book-Entry System**”) maintained by DTC.

DTC and Its Participants. DTC will act as securities depository for the Series 2016A Bonds. The Series 2016A Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered bond certificate will be issued for the Series 2016A Bonds of each stated maturity, in the aggregate principal amount of the Series 2016A Bonds of such stated maturity, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“**Direct Participants**”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“**DTCC**”). DTCC is the holding company for DTC, National Securities

Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“*Indirect Participants*”). DTC has a Standard & Poor’s rating of AA+. The DTC rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Series 2016A Bonds under the Book-Entry System must be made by or through Direct Participants, which will receive a credit for the Series 2016A Bonds on DTC’s records. The ownership interest of each actual purchaser of a Series 2016A Bond (“*Beneficial Owner*”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2016A Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2016A Bonds, except in the event that use of the Book-Entry System for the Series 2016A Bonds is discontinued.

To facilitate subsequent transfers, all Series 2016A Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2016A Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2016A Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Series 2016A Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2016A Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2016A Bonds, such as redemptions, tenders, defaults, and proposed amendments to security documents. For example, Beneficial Owners of the Series 2016A Bonds may wish to ascertain that the nominee holding the Series 2016A Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices will be sent to DTC. If less than all of the Series 2016A Bonds of any stated maturity are being redeemed, DTC’s practice is to determine by lot the amount of the interest of each Direct Participant in the Series 2016A Bonds to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2016A Bonds unless authorized by a Direct Participant in accordance with DTC’s MMI procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Bond Trustee as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the Series 2016A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption or purchase proceeds and interest payments on the Series 2016A Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC’s practice is to credit Direct Participants’ accounts, upon DTC’s receipt of funds and corresponding detail information from the Issuer or the Bond Trustee on the payable date in accordance with their respective holdings shown on DTC’s records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with Series 2016A Bonds held for the accounts of customers in bearer form or registered in “street name,” and will be the responsibility of such Participant and not of DTC, the Bond Trustee, the Issuer or

BSW Holdings, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest and redemption or purchase proceeds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Bond Trustee, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

Discontinuance of DTC Services. DTC may discontinue providing its services as securities depository with respect to Series 2016A Bonds at any time by giving reasonable notice to the Issuer and the Bond Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, Series 2016A Bond certificates are required to be printed and delivered.

The Issuer may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Series 2016A Bond certificates will be printed and delivered to DTC.

Use of Certain Terms in Other Sections of this Official Statement. While the Series 2016A Bonds are in the Book-Entry System, reference in other sections of this Official Statement to owners of such Series 2016A Bonds should be read to include any person for whom a Participant acquires an interest in the Series 2016A Bonds, but (i) all rights of ownership, as described herein, must be exercised through DTC and the Book-Entry System and (ii) notices that are to be given to registered owners by the Bond Trustee will be given only to DTC. DTC is required to forward (or cause to be forwarded) the notices to the Participants by its usual procedures so that such Participants may forward (or cause to be forwarded) such notices to the Beneficial Owners.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Issuer believes to be reliable, but neither the Issuer nor BSW Holdings takes any responsibility for the accuracy thereof.

SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2016A BONDS

The description and summaries of various documents set forth below and in **APPENDIX C** do not purport to be comprehensive or definitive, and reference is made to each document for the complete details of all terms and conditions. Copies of the Loan Agreement, the Bond Indenture, the Master Indenture and the Series 2016A Note will be available for inspection at the corporate trust office of the Bond Trustee.

The Bond Indenture

The Series 2016A Bonds are to be issued pursuant to, and will be equally and ratably secured by, the Bond Indenture. The Bond Indenture provides that all Series 2016A Bonds will be limited obligations of the Issuer, payable solely from and to the extent of and secured solely by the payments made by BSW Holdings under the Loan Agreement, payments made by the Obligated Affiliates on the Series 2016A Note, and certain funds established under the Bond Indenture. As security for its obligations under the Bond Indenture, the Issuer will pledge and assign to the Bond Trustee (1) all right, title and interest of the Issuer in the Loan Agreement, including all Loan Payments and the Series 2016A Note, but excluding indemnification and certain other expenses and costs payable to the Issuer, and (2) all funds and investments held by the Bond Trustee under the Bond Indenture.

THE SERIES 2016A BONDS ARE LIMITED OBLIGATIONS OF THE ISSUER AND ARE NOT IN ANY RESPECT OBLIGATIONS OF THE STATE OF TEXAS OR ANY POLITICAL SUBDIVISION OR AGENCY THEREOF, INCLUDING TARRANT COUNTY, TEXAS, AND ARE NOT PAYABLE IN ANY MANNER BY TAXATION. NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF TEXAS OR ANY POLITICAL SUBDIVISION OR AGENCY THEREOF, INCLUDING TARRANT COUNTY, TEXAS, IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, PREMIUM, IF ANY, OR INTEREST ON THE SERIES 2016A BONDS.

The Loan Agreement

Pursuant to the Loan Agreement, the Issuer agrees to issue the Series 2016A Bonds and loan the proceeds thereof to BSW Holdings by depositing such proceeds with the Bond Trustee under the Bond Indenture. Payments due from BSW Holdings under the Loan Agreement are due on each date for the payment of the principal of, premium, if any, or interest on the Series 2016A Bonds in an amount which, together with any other money available in the Bond Fund under the Bond Indenture, will equal the amount of principal of, premium, if any, and interest required to be paid on the Series 2016A Bonds on such date. BSW Holdings will pay such amounts directly to the Bond Trustee for deposit under the Bond Indenture. The obligation of BSW Holdings to make such payments is absolute and unconditional. **However, such obligation may be released or changed as described under “The Master Indenture — Replacement Master Indenture” below and “THE MASTER INDENTURE – Replacement Master Indenture” in APPENDIX C. See also “BONDHOLDERS’ RISKS – BSW Holdings and the Other Obligated Affiliates May Enter into a New Replacement Master Indenture.”**

The Master Indenture

General. The Master Indenture authorizes the issuance of the Series 2016A Note and other obligations thereunder from time to time. Obligations issued under the Master Indenture are referred to herein as “Master Debt.” After issuance of the Series 2016A Notes and the Taxable Bonds, \$2.877 billion principal amount of Senior Master Debt will be outstanding under the Master Indenture (exclusive of Senior Master Debt relating to (a) bank lines of credit for which no funds have been advanced, (b) credit and liquidity support for outstanding put debt for which no funds are owed and (c) interest rate swaps for which no funds are owed). See “**PRO FORMA AGGREGATE ANNUAL DEBT SERVICE REQUIREMENTS**” herein and “**FINANCIAL INFORMATION — Debt and Capitalization**” in APPENDIX A.

Obligated Affiliates. At the time the Series 2016A Bonds are issued, BSW Holdings, BSW Health, BHCS, S&W, Baylor University Medical Center, Baylor All Saints Medical Center, Scott & White Memorial Hospital, Baylor Regional Medical Center at Grapevine, Baylor Medical Center at Waxahachie, Baylor Regional Medical Center at Plano, Baylor Medical Centers at Garland and McKinney, Scott & White Clinic, Scott & White Hospital – Round Rock, Scott & White Continuing Care Hospital, Scott & White Hospital – College Station and Hillcrest Baptist Medical Center will be the only Obligated Affiliates under the Master Indenture. The Master Indenture permits other Persons to become Obligated Affiliates upon compliance with certain requirements set forth in the Master Indenture. Under the Master Indenture, each Obligated Affiliate may, upon compliance with the conditions set forth therein, execute and deliver as Master Debt under the Master Indenture additional promissory notes, drafts, bonds and guarantees, and other obligations which evidence or are indebtedness (or related fee, expense, reimbursement, indemnity, or Financial Hedge obligations or any obligations to reimburse advances or make other payments under a letter of credit, surety bond, bond insurance policy, bond purchase agreement, direct purchase agreement, or similar credit or liquidity obligations, in each case whether entered into before, contemporaneously with, or after the incurrence of such Debt). See “**THE MASTER INDENTURE — Issuance of Master Debt Under the Master Indenture**” in APPENDIX C.

Other persons may become Obligated Affiliates by delivering to the Master Trustee an agreement to comply with and be bound by the terms and provisions of the Master Indenture, to pay all Master Debt issued by it and to guarantee the payment of all other Master Debt issued under the Master Indenture. In addition, an Obligated Affiliate may withdraw as an Obligated Affiliate under the Master Indenture and be released of its obligations thereunder. However, before an entity may become an Obligated Affiliate (or before an Obligated Affiliate may withdraw as an Obligated Affiliate), the Master Trustee must receive certain certificates, legal opinions and other items specified in the Master Indenture. See “**THE MASTER INDENTURE — Concerning the Obligated Affiliates**” in APPENDIX C.

All Master Debt, including Master Debt incurred after issuance of the Series 2016A Bonds, is entitled to the benefit of the Master Indenture as general obligations of the Obligated Affiliates. Each Obligated Affiliate promises to pay any Master Debt issued by it under the Master Indenture. In addition, each Obligated Affiliate unconditionally guarantees the timely payment of all Master Debt issued by other Obligated Affiliates under the Master Indenture. Obligated Affiliates may also incur indebtedness other than Master Debt. Subject to certain

conditions set forth in the Master Indenture, such additional Master Debt or other indebtedness may be secured by security, including liens on the property financed or on pledges of charitable contributions, which security need not be extended to any other Master Debt or other indebtedness. See “**THE MASTER INDENTURE — Limitations on Liens**” in **APPENDIX C**.

Combined Group. The Master Indenture contemplates that each Obligated Affiliate may designate certain other entities, including without limitation entities which it controls, as “Restricted Affiliates.” The financial performance of Restricted Affiliates may or may not be taken into account in measuring compliance by the Obligated Affiliates with their covenants in the Master Indenture. Restricted Affiliates and the Obligated Affiliates are referred to collectively as the “Combined Group.” Restricted Affiliates do not guarantee payment of the Series 2016A Note or any other obligation of the Obligated Affiliates under the Master Indenture. **No entity has been designated a Restricted Affiliate, and the only members of the Combined Group as of the date of issuance of the Series 2016A Bonds are the Obligated Affiliates.** See “**BAYLOR SCOTT & WHITE HEALTH OVERVIEW — Obligated Group**” in **APPENDIX A**.

In the event that an Obligated Affiliate designates a Restricted Affiliate in the future, such Restricted Affiliate must enter into an undertaking that it will comply with Master Indenture covenants applicable to such Restricted Affiliate. See “**THE MASTER INDENTURE — Concerning the Restricted Affiliates**” in **APPENDIX C**. One of the covenants applicable to a Restricted Affiliate is that it will pay to an Obligated Affiliate, subject to legal restrictions on payments that would render the Restricted Affiliate insolvent, such amounts as may be required from time to time to permit such Obligated Affiliate to pay outstanding Master Debt under the Master Indenture. A Restricted Affiliate may be released from its obligations as a Restricted Affiliate at any time so long as no default would arise under the Master Indenture by following the procedures described under “**THE MASTER INDENTURE — Concerning the Restricted Affiliates**” in **APPENDIX C**. The Master Trustee is authorized to enforce such undertakings by the Restricted Affiliates upon the occurrence of an Event of Default under the Master Indenture.

Covenants. General. The Obligated Affiliates are required to observe certain covenants under the Master Indenture, including, without limitation, covenants regarding rates and charges, mergers and consolidations and maintenance of insurance. The Master Indenture imposes no restriction upon the ability of any member of the Combined Group to incur unsecured debt or to transfer assets, including cash and property in the Trust Estate, to Persons within or outside the Combined Group. The Master Indenture limits the liens that may be granted or permitted to exist on property of the Obligated Affiliates and the Restricted Affiliates. The Master Indenture does not restrict the incurrence of liens by affiliates of BSW Holdings that are not Obligated Affiliates or Restricted Affiliates. **The Master Indenture may be released, or replaced by an alternate indenture with materially different terms, covenants and obligors, on certain conditions, and without the consent of holders of Master Debt or owners of the Series 2016A Bonds.** See “**— Replacement Master Indenture**” below and “**THE MASTER INDENTURE — Replacement Master Indenture**” in **APPENDIX C**.

Financial Covenants and Calculation Thereof. The Master Indenture requires the Obligated Affiliates to conduct their business, and to cause the Restricted Affiliates (if any are designated in the future) to undertake to conduct their business, so that in each Fiscal Year, “Consolidated Net Revenues” total at least 1.10 times the “Maximum Annual Debt Service Requirements,” each as defined in **APPENDIX C**. The Master Indenture allows BSW Holdings to provide, and to calculate compliance with its financial covenants on, either “System Financial Statements” or “Combined Group Financial Statements,” as such terms are defined in **APPENDIX C**. System Financial Statements reflect the financial information of the Combined Group and any Affiliates required by generally accepted accounting principles to be consolidated with the financial information of the Combined Group, while Combined Group Financial Statements reflect only the financial information of the Combined Group. Pursuant to generally accepted accounting principles, the operations of the affiliates of BSW Holdings are reflected in the System Financial Statements and may be taken into consideration under the Master Indenture in determining compliance with the financial covenants in the Master Indenture, even though such entities are not Obligated Affiliates or Restricted Affiliates. Although BSW Holdings and the other Obligated Affiliates may control, directly or indirectly, the governing boards of such entities that are included in such financial statements, there are limitations on the ability of BSW Holdings and the other Obligated Affiliates to cause such entities to contribute funds to BSW Holdings and the other Obligated Affiliates, if needed, for payment on the Series 2016A Bonds. See

“BONDHOLDERS’ RISKS — BSW Holdings may be Limited in its Ability to Control Members of the System” herein.

Under the Master Indenture, provisions referring to the preparation of financial statements or the determination of specific elements appearing in financial statements in accordance with generally accepted accounting principles in the United States mean the generally accepted accounting principles at such time for the Person in question. Determinations, certifications, computations or other actions under the Master Indenture (including calculations of Annual Debt Service Requirements, Maximum Annual Debt Service Requirements, Consolidated Net Revenues and Net Revenues) are required to be prepared in accordance with generally accepted accounting principles in the United States used in the preparation of the financial statements of BHCS for the fiscal year ended June 30, 2013, subject, however, to certain adjustments and departures from generally accepted accounting principles that are permitted under the Master Indenture. See **“THE MASTER INDENTURE – Financial Statements”** in **APPENDIX C**.

Additional Restrictive Covenants. The Obligated Affiliates have entered into agreements with certain credit providers under which BSW Holdings and certain Obligated Affiliates have agreed (and have agreed to cause any future Obligated Affiliates) to observe and perform operating and financial covenants which are more restrictive than those contained in the Master Indenture.

Replacement Master Indenture. Upon the request of the Combined Group Representative and the delivery of a Replacement Master Indenture, the Master Trustee is required to accept the substitution of such Replacement Master Indenture for the Master Indenture, and the lien, rights, and interest created under the Master Indenture will cease, become null and void, and terminate. All cash, securities, and other personal property then held by the Master Trustee as part of the Trust Estate under the Master Indenture will be paid, assigned and transferred on the order of BSW Holdings, as Combined Group Representative, when the Master Trustee receives an opinion to the effect that:

- (A) the Replacement Master Indenture has been duly authorized, executed and delivered by those persons who are parties to, or who otherwise have become jointly and severally obligated under, the Replacement Master Indenture;
- (B) the acceptance of the Replacement Master Indenture and the release of the Master Indenture will not adversely affect any exemption from federal income taxation of interest on any bond secured by Master Debt under the Master Indenture; and
- (C) all requirements and conditions to the acceptance of the Replacement Master Indenture and the release of the Master Indenture have been complied with and satisfied.

Defined terms used under this heading have the meanings given such terms in **APPENDIX C**. See **“THE MASTER INDENTURE — Replacement Master Indenture”** in **APPENDIX C**.

BONDHOLDERS’ RISKS

A purchase of Series 2016A Bonds involves certain investment risks that are discussed throughout this Official Statement, including the Appendices. Each prospective purchaser of Series 2016A Bonds should make an independent evaluation of all the information presented in this Official Statement, including the Appendices, in order to make an informed investment decision.

Risks Associated with BSW Holdings’ Ability to Provide for Payment of the Series 2016A Bonds

The Series 2016A Bonds are limited obligations of the Issuer. They are payable by the Issuer only from and to the extent of (i) payments by BSW Holdings on the Series 2016A Note pledged under the Bond Indenture, (ii) payments by other Obligated Affiliates on their guaranty of the Series 2016A Note under the Master Indenture, and (iii) any other funds held by the Bond Trustee under the Bond Indenture, other than the rebate fund.

BSW Holdings' ability to make payments on the Master Debt outstanding under the Master Indenture depends on the financial condition and operating performance of the Obligated Affiliates and other affiliates, which are subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond its control. There can be no assurance that the Obligated Affiliates will maintain a level of cash flows from operating activities sufficient to permit them to pay the principal, premium, if any, and interest on the Master Debt.

Risks that could affect the Obligated Affiliates' ability to pay the Master Debt are discussed below. Prospective investors should carefully consider these risks as well as the other information contained in this Offering Memorandum before deciding to purchase Bonds. In addition, other risks and uncertainties not currently known to BSW Holdings or those it currently views to be immaterial also may materially and adversely affect the business, financial condition or results of operations of the System.

The System Could Be Adversely Affected by Health Care Reform Legislation in Ways and To an Extent That Cannot Be Predicted

In February of 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 ("**ARRA**"). ARRA includes several provisions that were intended to provide financial relief to the health care sector, including a requirement that states promptly reimburse healthcare providers. ARRA also established a framework for the implementation of a nationally-based health information technology program, including incentive payments that commenced in 2011 to eligible healthcare providers to encourage the implementation of health information technology and the "meaningful use" of electronic medical records. Assuming federal funding is available, the incentive payments are payable annually for a period of up to four years to eligible providers that demonstrate "meaningful use" of certified electronic health record technology ("**CEHRT**"). Pursuant to ARRA, and commencing in 2016, Medicare eligible providers that do not demonstrate "meaningful use" of CEHRT receive a significant downward adjustment in federal reimbursement. The payment reduction starts at 1% and increases each year that an eligible professional does not demonstrate meaningful use, to a maximum of 5%. Additionally, beginning in 2014, the federal government (including the Centers for Medicare & Medicaid Services ("**CMS**"), an agency of the United States Department of Health and Human Services ("**HHS**")), has commenced audits of providers that have received meaningful use payments. A hospital or provider that fails the audit will have the opportunity to appeal. Ultimately, hospitals or providers that fail on appeal will have to repay any incentive payments received through these programs.

In March of 2010, Congress enacted the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the "**Reform Acts**"). The Reform Acts mandate substantial changes in how and to whom government and private health insurance is provided and how much providers of health care services to government insured patients are paid. One of the primary drivers of this health care reform legislation is to provide or make available, or subsidize, the premium costs of health care insurance for uninsured, or underinsured, consumers who fall below certain income levels. Provisions listed below aim to decrease the uninsured population in the System's service areas and decrease its expenses for bad debt and charity care, although to an extent that still cannot be accurately predicted:

- **Insurance Premiums Subsidies:** subsidies for insurance premium costs to individuals and families based upon their income relative to federal poverty levels;
- **Voluntary Medicaid Expansion:** substantially increasing the federally and state-funded Medicaid insurance program, to all individuals under age 65 with incomes up to 133% of the Federal Poverty Level, although the U.S. Supreme Court has ruled that the expansion is optional for the states, and authorizing states to establish federally subsidized non-Medicaid health plans for low-income residents not eligible for Medicaid;
- **Individual Insurance Mandate:** requiring consumers to obtain, and for certain employers to provide, a minimum level of health care insurance, enforced through penalties (i.e., taxes) on consumers and employers that do not comply with these mandates;

- **Employer Insurance Expansion:** requiring most employers with more than 50 employees to provide health insurance to employees or pay a federal penalty, although the executive branch of the federal government (the “*Administration*”) extended the deadline to 2015 for employers with 100 or more full-time employees and 2016 for employers with 50 to 99 full-time employees; and
- **Regulating Coverage:** mandating private health insurance benefits and expansion of coverage for dependents, and preventing private health insurers from limiting annual benefits, denying coverage due to pre-existing conditions (effective immediately for children), or rescinding coverage, among other provisions.

In April of 2014, Congressional Budget Office (“*CBO*”) estimated that 26 million more people will be insured each year from 2017 through 2024 than would have been without the Reform Acts. To the extent all or any of those provisions produce the intended result, an increase in utilization of health care services by those who are currently avoiding or rationing their health care can be expected and bad debt expenses may be reduced. These provisions, when and if implemented, are expected to decrease the uninsured population in the System’s service areas and decrease its expenses for bad debt and charity care, but to an extent that cannot be accurately predicted.

The Reform Acts will likely pay providers less for health care services provided under federally-funded health insurance programs by:

- **Reducing Payments:** reducing increases in Medicare “market baskets” used to determine compensation rates by amounts estimated to total \$150 billion over 10 years; reducing Medicaid disproportionate share (“*DSH*”) funding by \$4 billion over 10 years; denying payment to those hospitals with excess readmissions compared to the national average for three patient conditions (i.e., acute myocardial infarction, pneumonia and heart failure); reducing payments under the Medicare Advantage program, which has been delayed to date but, if implemented, may result in increased premiums or out-of-pocket costs to Medicare beneficiaries enrolled in Medicare Advantage; further decreasing Diagnosis-Related Group (“*DRG*”) payments generally and adjusting payments to incentivize the delivery of quality care (and the achievement of positive outcomes for patients), and requiring that Medicare’s contingent fee third-party audit program be extended to Medicaid payments; and
- **Innovation:** establishing a Center for Medicare and Medicaid Innovation to develop incentive-based Medicare reimbursement to hospitals under the value-based purchasing program centered on quality and efficiency measures that are expected to further reduce payments for services to Medicare-insured patients, increasingly linking payments to patient outcomes, and establishing an Independent Payment Advisory Board to propose further reductions in Medicare payments.
- **Independent Payment Advisory Board (“*IPAB*”):** beginning January 15, 2019, if the Medicare growth rate exceeds the target, IPAB is directed to make recommendations for cost reduction for implementation by HHS, and those recommended reductions will be automatically implemented unless Congress adopts alternative legislation that meets equivalent savings targets. While hospitals are largely exempted from the recommendations from IPAB, industry experts also expect that government cost reduction actions may be followed by private insurers and payors. In June 2015, the House of Representatives voted to repeal the IPAB, although the Senate has not yet approved the legislation. Alternatively, the fiscal year 2017 federal budget proposal aims to strengthen the IPAB.

BSW Holdings expects these provisions to materially reduce or limit future increases in the payments that the System receives for providing services to patients covered by government programs.

The Reform Acts attempt to increase competition among private health insurers by providing for transparent state insurance exchanges. The health insurance exchanges may have a positive impact for providers by increasing the availability of health insurance to individuals who were previously uninsured. Conversely, employers

or individuals may shift their purchase of health insurance to new plans offered through the exchanges, which may or may not reimburse providers at rates equivalent to the rates the providers currently receive. The Reform Acts also prevent private insurers from adjusting insurance premiums based on health status, gender, or other specified factors. BSW Holdings expects that these provisions are likely to impact its expenses and/or revenues to an extent that cannot yet be accurately predicted. It is also expected that these provisions could adversely affect the credit of private insurers obligated to pay the System for services provided to patients insured by them.

The Reform Acts reduce payments for services to patients covered by government programs because Congress expected that providers will realize savings in bad debt and charity care expenses, as they are expected to provide care to fewer uninsured patients as a result of mandated increases in insurance coverage. However, the constitutionality of certain of the Reform Acts' provisions designed to expand health insurance coverage was challenged, and while the U.S. Supreme Court decided that the penalty for noncompliance with the individual mandate is constitutional as a valid exercise of Congress' taxing power, the Medicaid expansion provisions were found constitutional only in part. The Supreme Court, in *National Federation of Independent Business v. Sebelius*, permitted the offer of increased federal Medicaid funds with conditions attached, but struck down the Reform Acts' provisions eliminating federal Medicaid funding for those states that do not accept the new funds as an unlawful coercion of the states by the federal government. Therefore, states may choose to accept or not to accept the new federal Medicaid funds with the attached conditions without risking the loss of all federal Medicaid funding. In a separate case, *King v. Burwell*, the Supreme Court confirmed that the language of the Reform Acts permits consumers to receive premium tax credits for obtaining health insurance through insurance exchanges that are not run by the state but instead through the default, federally-run exchange.

Certain members of Congress have continued to support full repeal of, or propose legislative alternatives to, the Reform Acts. In addition, the Texas Governor continues to oppose Texas's implementation of the Medicaid expansion contemplated by the Reform Acts, and the Texas Legislature has not taken any action to expand the current Medicaid program. If Texas continues to choose not to participate in expansion of the Medicaid program, reductions in bad debt and charity care expenses may not be fully realized by the System, since it is likely that a significant number of indigents in the System's service areas would remain uninsured. In addition, healthcare insurance premium assistance will not be available for undocumented patients, so the Reform Acts are not expected to reduce the number of uninsured undocumented System patients.

The Reform Acts could result in reductions in employer-sponsored medical plans if employers choose to pay a fee rather than provide medical insurance, and individuals could elect to be uninsured if they deem the tax penalty under the Reform Acts more financially prudent, especially given the Reform Acts' prohibition against excluding coverage for prior conditions. Moreover, high deductible health insurance plans have become more common in recent years, and the Reform Acts are expected to encourage the increase in high deductible health insurance plans as the exchanges offer a variety of plans, several of which include lower monthly premiums in return for high deductibles. High deductible health plans may contribute to lower inpatient volumes as patients may forgo or choose less expensive medical treatment to avoid having to pay the costs of the high deductibles. However, there is also concern that the high deductibles will lead to an increase in bad debt expenses as some patients may not be able to pay the high deductibles. Accordingly, even if the Reform Acts' provisions are fully implemented, there can be no assurance that the System will realize sufficient savings in bad debt and charity care expenses to offset reductions in payments for services to Medicare patients. If the revenue received by the System for providing services to Medicare patients is insufficient to cover the costs of furnishing the services, and if the System does not realize offsetting reductions in bad debt and charity care expenses, the Reform Acts will have an adverse effect on the System.

It is difficult to predict the full impact of the Reform Acts due to the law's complexity, lack of implementing regulations or interpretive guidance, and gradual implementation, as well as an inability to foresee how states, businesses and individuals will respond to the choices afforded them by the law. BSW Holdings is therefore unable to predict the full impact of the Reform Acts on the System at this time. Moreover, in the past decade, legislators in various states have introduced proposals to reform their respective state's health care delivery system, including proposals to create a statewide single-payer system. Such legislation or regulations, if ever enacted in Texas, could have a material adverse effect on The Obligated Affiliates and their operations.

The financial and other results of operation included in **APPENDICES A and B** were realized prior to full implementation of the Reform Acts. No assurance can be given that they are indicative of results of operation that the System will be able to achieve after full implementation.

The System is Largely Dependent on, and Could Be Adversely Affected by Changes in, Federal and State Funding

A material percentage of the System's gross patient service revenues were derived from the federally funded Medicare program and the federal and state funded Medicaid program for the six months ending December 31, 2015. See "**FINANCIAL INFORMATION – Payor Mix by Gross Revenue**" in **APPENDIX A**. As a result, the System is highly dependent on funding of these programs.

Medicare. The System provides healthcare services to Medicare beneficiaries, and System providers are enrolled and certified to participate in the Medicare program where applicable. Under Medicare, the federal government pays physicians, hospitals and other providers for services furnished to eligible elderly and disabled persons. Medicare pays providers for most hospital, outpatient provider and physician services on the basis of fixed fee schedules rather than the actual costs of providing the services. Therefore, if Medicare funding does not keep pace with costs of services, or if costs of participation increase, the System's finances could be adversely affected, and the effect could be substantial.

Effective October 1, 2013, CMS adopted a policy known as the Inpatient Hospital Prepayment Review "Probe & Educate" review process or the "Two-Midnight" rule. With some exceptions, the "Two-Midnight" policy specifies that hospital stays spanning two or more midnights after the beneficiary is properly and formally admitted as an inpatient will be presumed to be "reasonable and necessary" for purposes of inpatient reimbursement. CMS adopted the policy due to growing concern with the overuse of the "observation" status at hospitals; CMS found that Medicare beneficiaries were spending extended period of times in observation units without being admitted as inpatients. After widespread concern was raised about the original proposed "Two-Midnight" rule, a moratorium on enforcement of the rule by Medicare Recovery Audit Contractors ("**RACs**") applied to inpatient hospital admissions from October 1, 2013 through December 31, 2015. CMS proposed changes to the "Two-Midnight" rule in mid-2015, and adopted those changes in October 2015 as part of the 2016 Medicare Outpatient Prospective Payment System ("**OPPS**") final rule. As modified, stays of less than two midnights are not automatically considered inappropriate for inpatient reimbursement, but are subject to a "physician judgment" exception if the medical necessity of the short stay is appropriately documented. Moreover, the 2015 Medicare OPPS final rule implemented a change to the requirement that certifications must be provided for all inpatient admissions. Going forward, CMS will require physician certification only for outlier cases and long stay cases of 20 days or more. An admission order will continue to be required for all inpatients when that patient has been formally admitted to the hospital. The effect of the Two Midnight rule on the Obligated Affiliates' operations is still unclear.

The Sustainable Growth Rate ("**SGR**"), which is a limit on the growth of Medicare payments for physician services, is linked to changes in the U.S. Gross Domestic Product over a ten-year period. SGR targets are compared to actual expenditures in order to determine subsequent physician fee schedule updates. Since 2003, Congress has passed legislation to delay application of the SGR. On April 16, 2015, the Medicare Access and CHIP Reauthorization Act of 2015 was signed into law, which permanently ended use of the SGR, and went into effect in July 2015. The legislation moves the SGR program from a fee-for-service to a pay-for-performance model that will control the growth of physician payments based on clinical outcomes. This legislation increases physician Medicare reimbursement by 0.5% annually until 2019 and then provides for no additional increases to base physician reimbursement through 2025. In addition to the base payment methodology, physicians can earn merit-based payments based on factors including compliance with meaningful use of electronic health records requirements and demonstration of the principles of quality-based medicine. Ultimately, it remains unclear what effect this legislation will have on the Obligated Affiliates' operations, including whether the reimbursement will cover the actual costs of providing physician services to Medicare beneficiaries.

Inpatient Cost. The System's acute care hospitals are paid for services they provide to Medicare inpatients under an inpatient prospective payment system ("**IPPS**"). Medicare pays a predetermined rate for each covered hospitalization, which depends on the DRG applicable to the treatment or condition for which a patient is admitted

and, in the case of the service component, is based upon the national average costs to care for patients for the specific DRG, adjusted for geographic wage differences, and, in the case of the capital component, at a per-case federal rate, adjusted for limited hospital-specific characteristics. DRG payment rates are adjusted annually for inflation and as part of the federal budget reconciliation process and, thus, are vulnerable to deficit reduction efforts. In addition, DRG payments can be reduced or voided as a result of failing to comply with certain quality measures. The reductions in market basket updates and productivity adjustments have had a disproportionately negative effect upon those providers that are relatively more dependent upon Medicare than other providers. Additionally, these reductions were effective prior to the periods during which insurance coverage and the insured consumer base was expanded. The combination of reductions to the market basket updates and the imposition of productivity adjustments may, in some cases and in some years, result in reductions in Medicare payment per discharge on a year-to-year basis. The System is paid for hospital services provided to Medicare outpatients under the Medicare OPSS, although payments are not adjusted for geographic wage differences. Medicare also compensates hospitals involved in graduate medical education (“*GME*”) with additional payments, although these payments are vulnerable to reduction or elimination. The fiscal year 2017 federal budget proposes to reduce Medicare indirect GME payments by 10%. For fiscal year 2015, a significant percentage of the System’s gross patient revenue was received under the Medicare IPPS and OPSS, including graduate medical education compensation. See “**FINANCIAL INFORMATION – Payor Mix by Gross Revenue**” in **APPENDIX A**.

Outpatient Costs. CMS pays hospitals for Medicare outpatient hospital services under the Medicare OPSS. The Medicare OPSS covers most Medicare-participating hospitals and includes most outpatient hospital services as well as certain inpatient ancillary services provided to Medicare hospital inpatients who have exhausted their Part A benefit. Similar to the DRG classification system used for the Medicare IPPS, the Medicare OPSS uses an ambulatory payment classification (“*APC*”) system. The APC system divides outpatient services covered by Medicare into groups of services, or “*APCs*.” Relative payment weights are assigned to each APC, and APC payment rates are adjusted for cost inflation (subject to budget reconciliation) and failure to report adequate performance under specified quality of service measures, but not for geographic wage differences.

The Reform Acts are intended to substantially reduce or slow the growth in federal Medicare spending, as described above, and further payment and similar restrictions could be enacted in the future. In order to raise the federal government’s borrowing capacity, as part of the Budget Control Act of 2011 (the “*BCA*”), as modified by the Taxpayer Relief Act of 2012 (the “*Taxpayer Relief Act*”), Congress agreed to automatic federal program spending cuts, known as sequestration, over the next decade totaling \$1.2 trillion, unless alternate budgetary reduction legislation was enacted. In December of 2013, Congress partially replaced the mandatory budget cuts but only for two years as part of the Bipartisan Budget Act of 2013 (the “*2013 Budget Act*”). While the 2013 Budget Act lifted certain sequestration cuts for defense and non-defense spending for fiscal years 2014 and 2015, it did not reduce the sequestration reductions impacting mandatory programs including Medicare. Thus, the 2% reduction to Medicare payments will continue at least through March 31, 2016, for Medicare fee-for-service program claims with dates of service or dates of discharge on or after April 1, 2013, unless additional Congressional action is taken. The 2013 Budget Act further provided for a restructuring of Medicaid DSH payment reductions by delaying the fiscal year 2014 DSH payment cuts until fiscal year 2016, but that legislation also increased the overall level of reductions and extended cuts through fiscal year 2023. The Medicare Access and CHIP Reauthorization Act of 2015 again delayed the DSH payment cuts until fiscal year 2018, but increased the scope of the reductions and extended the cuts through fiscal year 2024. The Obligated Affiliates depend significantly on Medicare as a source of revenue. Because of this dependence, changes in the Medicare program may have a material effect on the Obligated Affiliates. As indicated above, the Reform Acts will present an unknown financial impact on all hospitals. Future reductions in Medicare reimbursement, or increases in Medicare reimbursement in amounts less than increases in the costs of providing care, may have a material adverse financial effect on the Obligated Affiliates.

On November 2, 2015, President Obama signed the Bipartisan Budget Act of 2015 (“*2015 Budget Act*”), increasing the budget caps imposed by the BCA for fiscal years 2016 and 2017 and authorizing \$80 billion in increased discretionary spending over the next two years. The 2015 Budget Act also suspends the limit on the federal government’s debt until March 15, 2017.

It is not clear what impact, if any, the market basket reductions required by the Reform Acts will have on inpatient reimbursement rates overall. The market basket adjustments for inpatient hospital care have averaged

approximately 2 to 4% annually in recent years. The Reform Acts call for reductions in the annual market basket update amount ranging from 0.10 to 0.75% each year through federal fiscal year 2019. The Reform Acts call for a productivity adjustment to the market basket update, which is anticipated to result in an additional 1% annual reduction. Accordingly, there can be no assurance that future updates to Medicare prospective payment system payments will keep pace with inflation or with increases to the cost of providing services, or that Congress will continue to defer substantial reductions in physician compensation for services under Medicare. Under quality-based compensation efforts included in the Reform Acts, if the System fails to compare favorably with national averages for hospital-acquired conditions and readmissions, its revenue could be adversely and materially affected.

The Reform Acts also contain a number of provisions intended to promote value-based purchasing. Hospitals that satisfy certain performance standards are to receive increased Medicare payments for discharges during the following fiscal year, funded by decreases in payments to all hospitals for inpatient services, and hospitals are to receive reduced payments as a result of significant hospital-acquired conditions and readmission rates. For discharges since and including federal fiscal year 2014, the performance standards must assess hospital efficiency, including Medicare spending per beneficiary. On January 26, 2015, HHS announced a timetable for transitioning Medicare payments from the traditional fee-for-service model to a value-based payment system. This schedule calls for tying 30% of traditional Medicare fee-for-service payments to quality or value through alternative payment models, such as accountable care organizations or bundled payment arrangements, by the end of 2016, increasing to 50% by 2018. In addition, HHS has proposed that by 2016, 85% of all Medicare fee-for service payments have a component based on quality or efficiency of care, such as value-based purchasing or readmission reductions, increasing to 95% by 2018.

In addition, the Reform Acts provide for reduced payments based on a hospital's rate of hospital-acquired conditions ("**HAC**") and readmission rate and requires HAC rates and readmission rates to be made public. Effective July 1, 2011, the Reform Acts prohibited the use of federal funds under the Medicaid program to reimburse providers for medical assistance provided to treat HACs. Beginning in federal fiscal year 2015, hospitals that fall into the top 25% of national risk-adjusted HAC rates for all hospitals in the previous year receive a 1% reduction in Medicare payment rates. For discharges occurring effective October 1, 2012, hospitals with excessive readmissions for certain conditions (i.e., acute myocardial infarction, pneumonia and heart failure) receive reduced Medicare payments on inpatient admissions proportional to their excess readmission ratios. CMS continues to expand the readmission measures through final rulemaking. Further quality-based compensation efforts are included in the Reform Acts. Consequently, if the System fails to compare favorably with national averages for HACs and readmissions, its revenue could be adversely affected.

Provider-Based, Off-Campus Hospital Outpatient Departments. Section 603 of the 2015 Budget Act reduces Medicare payments to newly enrolled provider-based, off-campus hospital outpatient departments ("**HOPDs**") by excluding such facilities from payment under the Medicare OPPS beginning January 1, 2017. While this change does not affect already existing and enrolled provider-based, off-campus HOPDs that were billing for services prior to November 2, 2015, newly enrolled provider-based, off-campus HOPDs will receive lower payments than in previous years for providing the same services.

Other Medicare Service Payments. Medicare payment for skilled nursing services ("**SNFs**"), psychiatric services, inpatient rehabilitation services, general outpatient services and home health services are based on regulatory formulas or predetermined rates. There is no guarantee that these rates, as they may change from time to time, will be adequate to cover the actual cost of providing these services to Medicare patients.

Medicaid. Medicaid is a federal-state program that provides assistance with expenses for health care services to low-income individuals and families. Medicaid is funded jointly by the federal government and state governments and is administered by the states. Federal statutes and regulations establish the parameters within which the states must: establish their own eligibility standards; determine the type, amount, duration, and scope of covered services; set the payment rates for services; and administer their own programs. The Texas Medicaid program requires the great majority of residents in the System's service area who are eligible to participate in Medicaid to enroll in Texas Medicaid managed care programs, known as the STAR program (the primary managed care program) and the STAR+PLUS program (the managed care program for disabled and chronically ill patients or are age 65 or older). Under these programs, the state pays capitated health insurance premiums to insurers for

Medicaid-eligible insureds who elect or are required to obtain coverage, and the insurers negotiate payment rates with and pay hospitals and others for care provided to the insured patients.

In addition to traditional Medicaid payments for patient services, certain System hospitals also receive supplemental payments under the Texas Healthcare Transformation and Quality Improvement Program (the “*Waiver Program*”) (further described herein) and the Medicaid disproportionate share hospital program (the “*DSH Program*”). Revenues received by the System under the Waiver Program are included in net patient care revenues, net of patient related bad debt expense as shown in **APPENDIX A** under “**FINANCIAL INFORMATION – Summary Combined Financial Information – Selected System Financial Information.**” The DSH Program provides supplemental payments to hospitals that serve a disproportionately large share of Medicaid and other low-income patients.

In December 2011, the State of Texas received approval from the federal government for and implemented a waiver from certain federal Medicaid requirements for the five-year period ending September 30, 2016. The Waiver Program generally preserves Upper Payment Limit (“*UPL*”) funding under a new methodology, but allows for managed care expansion to additional areas of the State. Under the Waiver Program, in lieu of making UPL payments to hospitals, the State funds two payment pools – the Uncompensated Care (“*UC*”) Pool and the Delivery System Reform Incentive Payment (“*DSRIP*”) Pool – from which payment pools supplemental payments are made to providers. The UC Pool is intended to provide funding for hospitals and other providers to help offset the costs of uncompensated care. The DSRIP Pool is intended to provide funding incentives to hospitals and other providers to enhance access to care for and the health of patients. Under the Waiver Program, hospitals make proposals to receive payments to defray costs of innovations in their delivery systems to achieve these goals. The State created 20 Regional Healthcare Partnership (“*RHP*”) regions as part of the Waiver Program. The System has hospitals located in RHP 8, which includes Bell County, RHP 9, which includes Dallas, Kaufman and Denton Counties, RHP 10, which includes Tarrant, Hood, Erath, Johnson, Parker, Somervell, and Ellis Counties, RHP 16, which includes McLennan County, and RHP 17, which includes Washington County. Funds for the System’s RHPs are allocated by Texas A&M Health Science Center as the RHP 8 and 17 anchor hospital, Parkland Hospital as the RHP 9 anchor hospital, John Peter Smith Hospital as the RHP 10 anchor hospital, and Coryell County Memorial Hospital Authority as the RHP 16 anchor hospital. All of these anchor entities work in collaboration with area health care providers under protocols approved by the State and CMS. The State anticipates that funding will shift from the UC Pool to the DSRIP Pool over the five-year term of the waiver

In a letter dated September 30, 2014, to the Texas Health and Human Services Commission (“*THHSC*”), CMS announced that it was deferring the federal share of Waiver Program UC payments totaling between \$63 million and \$75 million for the third quarter of federal fiscal year 2014 to certain hospitals in Dallas, Tarrant, and Nueces Counties, including some System hospitals. In the deferral letter CMS explained that it needed to review certain funding arrangements and their compliance with federal provider-related donation prohibitions, including as interpreted by CMS in State Medicaid Director Letter #14-004 (May 9, 2014). In a subsequent letter dated January 7, 2015, to THHSC, CMS described that it was releasing the deferral but was continuing to review information provided by THHSC in support of the funding arrangements and if it would determine that any financing structure within the State Medicaid program violates federal law, CMS would expect the State to make necessary adjustments by December 2015. On March 9, 2015, CMS informed THHSC that the indigent care funding arrangements in Dallas and Tarrant Counties, which include some System hospitals, appear to violate the provider-based donation prohibition against a private hospital assuming a statutory obligation of a governmental entity, the statutory obligation in this case to provide or pay for health care services to the indigent. THHSC was given until December 2015 to resolve these concerns, and this issue is not yet finally resolved. In addition, under the Reform Acts, Medicaid DSH payments to states, and consequently to Medicaid-participating providers including the System acute care hospitals, will be reduced in the coming years.

Consequently, the continued receipt by System hospitals of supplemental payments under the Medicaid program will depend upon adequate State appropriations and federal DSH payments, the hospitals’ ability to compete for DSRIP payments and to achieve any patient access or health objectives on which they may be conditioned, CMS not deferring UC payments and even DSRIP payments (which deferral could result in recoupment of UC and/or DSRIP payments already received by the hospitals), and either extension of the Waiver Program beyond September 2016 or approval and implementation of a similar supplemental payments program.

The Waiver Program expires September 30, 2016, and THHSC submitted a request to CMS by the deadline of September 30, 2015 to extend the waiver. THHSC has requested an increase in the UC Pool to maintain neutrality for providers, but CMS has indicated publicly that it prefers expanded Medicaid coverage to supplemental payment pools. Thus, it is unknown whether CMS will extend part or all of the Waiver Program and whether the funding for the UC and DSRIP Pools will be as requested by THHSC or reduced. Given these contingencies, there can be no assurance that System hospitals will continue to receive Medicaid supplemental payments.

Medicaid Managed Care. There are three Medicaid managed care programs in Texas: STAR, STAR+PLUS, and STAR Health. The 2013 Texas Legislature approved several expansions of Medicaid managed care and directed HHSC to develop a performance-based payment system that rewards outcomes and enhances efficiencies. Under the STAR program, THHSC contracts with health maintenance organizations (“HMOs”) in a particular geographic service area to arrange for covered services to Medicaid beneficiaries. The HMOs contract with hospitals to obtain services for Medicaid beneficiaries at negotiated rates. The risks to HMOs that participate in the STAR program, and/or hospitals that contract with them, are the same as those discussed for Medicare HMOs above and contracts with managed care providers below.

State Funding Risks. The State of Texas, like most states, must operate with a balanced budget, and expenditures for the Medicaid program are among the State’s largest budgeted expenses. The current economic climate has increased budgetary pressures on the State, and these budgetary pressures have resulted, and likely will continue to result, in decreased spending for Medicaid. These reductions apply to both Medicaid fee-for-service and Medicaid managed care services. Additional legislation or regulations may be introduced to reduce coverage, enroll more Medicaid recipients in managed care programs, and/or impose additional taxes on hospitals to help finance or expand the State’s Medicaid system. In addition, THHSC is in the process of rebasing the inpatient hospital division payment standard dollar amounts, which is used in to calculate Medicaid inpatient reimbursement rates. This could result in lower reimbursement rates to the System.

RAC Audits

CMS has contracts with RACs to search for improper Medicare payments in all 50 states. RAC contractors retrospectively review provider claims for the following types of services: hospital inpatient and outpatient, SNF, physician, ambulance and laboratory, as well as durable medical equipment. The RAC program was expanded through the Reform Acts to Medicare Part C (Medicare Advantage plans), Medicare Part D (prescription drug coverage) and Medicaid.

The System could also be adversely affected if audits of its charges for Medicare or Medicaid patients were to allege overcharges in excess of reserves. If audits discover alleged overpayments, the System could be required to pay a substantial rebate of payments in the prior five years. While BSW Holdings believes that it has reserved sufficiently for future audit adjustments, ultimate liability could exceed reserves, and any excess could be substantial. BSW Holdings does not anticipate or have reason to believe that a substantial audit adjustment would be recommended as a result of a RAC audit; however, there can be no assurance that, if any audit adjustments were to be assessed, they would not have a material adverse effect on the financial position of the System.

These and future changes could negatively affect the System in a manner and to an extent that cannot be fully predicted.

Research Funding and Increased Enforcement of Clinical Trials Research

In addition to increasing enforcement of laws governing payment and reimbursement, the federal government has also stepped up enforcement of laws and regulations governing the conduct of clinical trials at hospitals. HHS elevated and strengthened the Office of Human Research Protection (“OHRP”), one of the agencies responsible for monitoring federally funded research. In addition, the National Institutes of Health (“NIH”) significantly increased the number of facility inspections that these agencies perform. The Food and Drug Administration (“FDA”) also has authority over the conduct of clinical trials performed in hospitals when these trials are conducted on behalf of sponsors seeking FDA approval to market the drug or device that is the subject of the research. The FDA’s inspection of facilities has increased significantly in recent years. These agencies’

enforcement powers range from imposing substantial fines and penalties to exclusion of researchers and suspension or termination of entire research programs. The System believes that the clinical research being conducted on behalf of each of the Obligated Affiliates and BSW Holdings is in substantial compliance with material applicable requirements, but no assurance can be made that the FDA will not take a contrary position or that such position will not have a material adverse effect on the future operations or financial condition of the Obligated Affiliates or BSW Holdings.

International Classification of Disease, 10th Revision Coding System

On October 1, 2015, the International Classification of Diseases, 10th Revision coding system (“*ICD-10*”) diagnostic code set went live. At this time, it is too early to predict whether health care organizations will experience negative effects due to ICD-10 implementation. ICD-10 provides a common approach to the classification of diseases and other health problems, allowing the United States to align with other nations to better share medical information, diagnosis, and treatment codes. ICD-10 is not without risk as staff had to be retrained, processes redesigned, and computer applications modified as the current available codes and digit size dramatically increased. Additionally, there is a potential for temporary coding and payment backlog, as well as potential increases in claims errors. There is a potential for revenue stream disruption for health care organizations and the magnitude of the transition within the industry may add pressure to health care organizations cash flows. Health care organizations were dependent on outside software vendors, clearinghouses and third-party billing services to develop products and services to allow timely, full and successful implementation of ICD-10. At this time, however, it is not possible to predict the effects of full ICD-10 implementation. With the recent implementation deadline, the full impact of the implementation of ICD-10 is evolving.

If the System Improperly Provides or Claims Compensation for Services, It Could Lose its Ability to Serve Medicare or Medicaid Beneficiaries or Incur Substantial Penalties

Federal Fraudulent Claims, Anti-Kickback and Stark Laws. The claim process for federal healthcare programs is subject to highly detailed statutory and regulatory requirements. In addition to disallowed costs, the System may be exposed to possible claims under the federal False Claims Act and other federal and state civil and criminal statutes for services provided to Medicare and Medicaid patients. Penalties that may be assessed for violations include a fine for each false claim submitted, payment of up to three times the amount of damages (false claims) sustained by federal health care programs and exclusion from participation in federal health care programs. If the System violates one of the fraud and abuse laws, among other possible sanctions, federal or state authorities could recover amounts paid to the hospital, exclude the hospital from participation in the Medicare/Medicaid programs, impose civil monetary penalties, and suspend Medicare/Medicaid payments. The federal government (and individuals acting on its behalf) have brought many investigations, prosecutions and civil enforcement actions under the fraud and abuse laws in recent years. In some cases, the scope of the fraud and abuse laws are so broad that they may result in liability for business transactions that are traditional or commonplace in the health care industry.

Federal Anti-Kickback Law. It is illegal to offer, pay, solicit or receive a payment in return for referring, ordering, recommending or arranging for the referral of any product or service covered by Medicare, Medicaid or other government health care programs. This prohibition has been broadly applied by the courts. Violations may result in civil and criminal penalties. Criminal penalties include imprisonment and fines not to exceed \$25,000. Civil penalties include temporary or permanent exclusion from government health care programs, civil money penalties up to \$50,000 per kickback and treble damages. The broad prohibitions of the anti-kickback law may be implicated when hospitals and physicians conduct joint business activities, such as physician recruiting programs, physician referral services, hospital-physician service or management contracts, space or equipment rentals between hospitals and physicians, and other service and vendor relationships. In the Reform Acts, Congress revised the intent requirement of the anti-kickback law to provide that a person is not required to “have actual knowledge or specific intent to commit a violation of” the anti-kickback law in order to be found guilty of violating such law. This change decreases the burden on the federal government to prove that a healthcare provider has violated the anti-kickback law. The Reform Acts also provide that any claims for items or services that violate the anti-kickback law are also considered false claims for purposes of the federal civil False Claims Act. Federal regulations describe certain arrangements (i.e., safe harbors) that are exempt from prosecution under the anti-kickback law. Because the

safe harbors are narrowly drawn, there can be no assurance that the Obligated Affiliates will not be found in violation of the anti-kickback law.

“Self-Referral” Prohibitions. Current federal law (known as the “*Stark*” law) prohibits any physician from referring certain Medicare or Medicaid covered designated health services to a provider of such services with which the physician (or his/her immediate family member) has a financial relationship, unless excepted by statute or regulation. Because the government does not need to prove any intent by a provider to violate the law, a small technical violation of the Stark law can trigger substantial financial penalties. Penalties for violating the Stark law could include denial of payment, refund of payments received, civil monetary penalties, and exclusion from the Medicare and Medicaid programs. In the Physician Fee Schedule final rule for calendar year 2016, CMS eased some of the technical burdens associated with Stark law compliance (e.g., CMS explains in the final rule that a single contract is not necessary and instead a collection of documents will suffice to demonstrate Stark law compliance), but the practical outcome remains unclear. However, there are numerous ambiguities and questions of interpretation in analyzing whether an arrangement violates the Stark law. As a result of the scarcity of case law interpreting the Stark law, there can be no assurance that System hospitals will not be found in violation of the Stark law. Therefore, the precise impact on System hospitals of any such violation and corresponding sanction cannot be predicted at this time, but would be negative if any such sanction is imposed.

CMS has established a voluntary self-disclosure program under which hospitals and other entities may report Stark Law violations and seek a reduction in potential refund obligations. However, the program is relatively new and it is therefore difficult to determine at this time whether it will provide significant monetary relief to hospitals that discover inadvertent Stark Law violations. The Members of the Obligated Group may make self-disclosures under this program as appropriate from time to time.

False Claims Acts. The federal civil False Claims Act (“*Civil FCA*”) prohibits anyone from knowingly submitting a false, fictitious or fraudulent claim to the federal government. Violations of the Civil FCA can result in civil money penalties and fines, including treble damages. Private individuals may initiate actions on behalf of the federal government in lawsuits called qui tam actions. The plaintiffs, or “whistleblowers,” can recover significant amounts from the damages awarded to the government. In several cases, Civil FCA violations have been alleged solely on the existence of alleged kickback arrangements or Stark law violations, even in the absence of evidence that false claims had been submitted as a result of those arrangements. In the Reform Acts, Congress creates Civil FCA liability for knowingly failing to report and return an overpayment within a specified time. The criminal False Claims Act (“*Criminal FCA*”) prohibits the knowing and willful making of a false statement or misrepresentation of a material fact in submitting a claim to the government. Sanctions for violations of the Criminal FCA include imprisonment, fines, and exclusions.

Amendments to the FCA in the Fraud Enhancement and Recovery Act of 2009 (“*FERA*”) and the Reform Acts amend and expand the reach of the FCA. FERA expanded the FCA’s reverse false claims provision, imposing liability on any person who “knowingly conceals” or “knowingly and improperly avoids or decreases” an “obligation to pay or transmit money or property to the Government,” whether the person uses a false record or statement to do so or not. FERA also clarified that an “obligation” can arise from the retention of an overpayment. Section 6402 of the Reform Acts further addresses the retention of overpayments by defining the term overpayment and the circumstances and timing under which an overpayment need be returned to the government before it becomes an “obligation” under the FCA. On February 12, 2016, CMS released a final rule interpreting Section 6402, including terms addressing when an overpayment has been “identified” for purposes of Section 6402, how to report and return overpayments, and establishment of a six-year lookback period. FERA and the Reform Acts also amend certain jurisdictional bars to the Reform Acts, effectively narrowing the public disclosure bar and expanding the definition of “original source,” thus potentially broadening the field of potential whistleblowers.

Civil Monetary Penalties Law. The Civil Monetary Penalties Law (“*CMP Law*”) in part authorizes the government to impose money penalties against individuals and entities committing a variety of acts. For example, penalties may be imposed for the knowing presentation of claims that are (i) incorrectly coded for payment, (ii) for services that are known to be medically unnecessary, (iii) for services furnished by an excluded party, or (iv) otherwise false. An entity that offers remuneration to an individual that the entity knows is likely to induce the individual to receive care from a particular provider may also be fined. Moreover, a hospital may not knowingly

make a payment, directly or indirectly, to a physician as an inducement to reduce or limit services to Medicare or Medicaid patients under the physician's direct care. In the Reform Acts, Congress amended the CMP Law to authorize civil monetary penalties for a number of additional activities, including (i) knowingly making or using a false record or statement material to a false or fraudulent claim for payment; (ii) failing to grant the Office of Inspector General ("**OIG**") timely access for audits, investigations, or evaluations; and (iii) failing to report and return a known overpayment within statutory time limits. Violations of the CMP Law can result in substantial civil money penalties plus three times the amount claimed.

Other Federal and State Statutes. Like other health care providers, the System is also subject to criminal prosecution and civil penalties under a variety of federal laws in addition to those discussed in the previous paragraphs, notably the Emergency Medical Treatment and Active Labor Act ("**EMTALA**"), which requires a hospital with an emergency department to provide an appropriate medical screening examination within the capability of the hospital's emergency department to any individual that comes to the hospital seeking treatment or examination for an emergency medical condition or active labor, notwithstanding the individual's ability to pay; the federal Health Insurance Portability and Accountability Act of 1996 ("**HIPAA**"), which mandates that health care providers transmit certain patient health information in accordance with HHS privacy and security standards; the Texas Non-Solicitation of Patients Act ("**TSPA**"), which is similar to the federal anti-kickback law; the Texas Medicaid Fraud Prevention Act, and the Texas Insurance Claim Fraud Act, which impose penalties for wrongfully charging for services under the Medicaid program or services covered by private health insurance.

Privacy and Security Regulations. The privacy and security of patient medical records and other health information is subject to considerable regulation by the federal government. For example, the administrative simplification provisions of HIPAA mandate that health care providers transmit certain patient health information in accordance with HHS standards and requirements. HIPAA mandates the adoption of federal privacy and security standards to protect the confidentiality of protected health information. Regulations designed to protect health information impose very complex procedures and operational requirements with which the System is obligated to comply. Failure to protect the privacy and security of protected health information could result in damages or civil or criminal penalties. In addition, violations may increase operating expenses as necessary to notify affected individuals of privacy or security breaches, correct problems, comply with federal and state regulations, defend against potential claims and implement and maintain any additional requirements imposed by government action.

The Health Information Technology for Economic and Clinical Health Act ("**HITECH Act**"), which is part of ARRA, significantly changed the landscape of federal privacy and security law with regard to individually identifiable health information. The HITECH Act (i) extended the reach of HIPAA, (ii) imposed a breach notification requirement on HIPAA covered entities, (iii) limited certain uses and disclosures of individually identifiable health information, (iv) increased individuals' rights with respect to individually identifiable health information, (v) increased enforcement of, and penalties for, violations of privacy and security of individually identifiable health information, and (vi) restricted covered entities' marketing communications.

The HITECH Act breach notification requirement created a uniform federal breach notification law that mirrors protections that many states have passed in recent years. The breach notification requirement requires the Obligated Affiliates to notify patients of any unauthorized access, acquisition, or disclosure of their unsecured protected health information unless it is demonstrated that there is a low probability that the protected health information was not compromised based on a four-factor test. In addition, all breaches must be reported to the Secretary of HHS. In breach cases involving greater than 500 individuals, local media outlets must be notified and the Secretary of HHS will also notify the public by posting a description of the breach on its website. These reporting obligations increase the risk of government enforcement as well as class action lawsuits, especially if large numbers of individuals are affected by a breach.

Any violation of the HITECH Act is subject to HIPAA civil and criminal penalties. The HITECH Act broadened the applicability of the criminal penalty provisions under HIPAA to employees of covered entities and required penalties for violations resulting from willful neglect. The HITECH Act also significantly increased the amount of civil penalties to up to \$1.5 million for violations during a calendar year under HIPAA. In addition, the HITECH Act authorized state attorneys general to bring civil actions seeking either injunction or damages in

response to violations of HIPAA privacy and security regulations that threaten state residents. The System believes that it is in substantial compliance with all applicable current requirements of HIPAA.

Other Texas Statutes. Health care providers in Texas also are subject to prosecution and civil penalties under state statutes, including the following:

Texas Non-Solicitation of Patients Act. The TSPA is similar to the federal anti-kickback law. TSPA prohibits any person, including hospitals and physicians, from knowingly offering to pay or agreeing to accept any remuneration directly or indirectly, overtly or covertly, in cash or in kind, to or from another person or entity, for securing or soliciting patients or patronage for or from a person licensed, certified or registered by a state health care regulatory agency. TSPA is extremely broad and applies to services covered by any payer, including private insurance and self-pay, while the federal anti-kickback law is limited to services covered under a government-funded health care program. A violation of TSPA is a criminal offense.

Texas Medicaid Fraud Prevention Act. The Texas Medicaid Fraud Prevention Act imposes civil penalties for various fraudulent acts performed with knowledge that relate to the application for or receipt of a benefit, contract or payment under the Medicaid program. Civil remedies for a violation of the Act include suspension or revocation of a Medicaid provider agreement, restitution, and penalties that may include twice the value of the unauthorized payment or benefit. A person found liable for violating this statute in a lawsuit for civil penalties brought by the Texas Attorney General will be barred from participating in the Medicaid program for at least 10 years. In addition, the relevant regulatory agency may suspend or revoke a provider agreement or a license issued to a liable defendant. A person who commits an unlawful act under the Texas Medicaid Fraud Prevention Act may also commit a crime under the Medicaid Fraud provisions in the Penal Code. The Act also authorizes a private person to bring an action for violation of the Act.

Texas Insurance Claim Fraud Act. The Texas Insurance Claim Fraud Act makes it illegal to, with the intent to defraud the insurer, (a) present a claim for payment to a health insurer that is known to be materially false or misleading and affects the right to or amount of payment or (b) solicit or offer a benefit in connection with goods or services for which payment is sought under a health insurance policy.

Possible Consequences of Violations. Any violations of the foregoing laws by the System or a System employed physician or other employee could result in substantial monetary fines and damages as well as its possible disqualification from participation in the Medicare and Medicaid programs. Regardless of the merits of a particular case or cases, the System could incur significant legal and settlement costs. Prolonged and publicized investigations could be damaging to reputation, business and credit, regardless of the outcome, and could have material adverse consequences on the financial results of operations of the System.

The System May Not Be Able to Maintain Contracts with Managed Care Providers for Adequate Payments

A material percentage of the System's consolidated gross patient service revenues is derived under "managed care" programs. See "**FINANCIAL INFORMATION – Payor Mix by Gross Revenue**" in **APPENDIX A**. Managed care plans use contractually agreed upon rates, utilization management techniques, and other mechanisms to limit the cost of health care services to plan members. Payments from managed care plans are typically lower than those received from traditional indemnity or commercial insurers. Managed care plans pay providers on a discounted fee-for-service basis, a discounted per-diem rate, or a prospective payment rate. The discounts negotiated by a managed care plan may result in payment that is less than actual costs and the volume of patients directed to a contracted provider may vary significantly from projections. Failure to maintain contracts with managed care organizations at acceptable payment rates could therefore reduce the System's market share and gross patient services revenues.

With continued implementation of the Reform Acts, substantial numbers of employers may elect to discontinue employer-funded medical care for employees eligible for federal assistance in securing private insurance or, by paying a tax, other employees, and the employees could then choose health insurance under the health insurance exchanges or elect to be uninsured. Individuals choosing their own coverage may become highly price sensitive, which could increase the number of people in HMO plans, thus increasing the use of capitation and

making price negotiations with HMOs and other insurance plans more difficult. Although the System currently has no fully capitated contracts with HMOs or other insurers, it could come under increased pressure to accept capitated or other incentive fee contracts with insurers. Individuals may also choose coverage with significant cost-sharing obligations, which might result in a decrease in elective procedures or an increase in bad debt experienced by the System.

In the service areas of the Central Texas Division and North Texas Division, managed care contracts have largely replaced indemnity insurance for patients who do not participate in the Medicare or Medicaid programs. Under managed care, third-party administrators negotiate contracted rates (for a short number of years) with preferred providers on behalf of the multiple employers for whom they manage employee healthcare costs. These contracts have increasingly included incentive and discount payments in order to encourage the provision of efficient and cost effective care. The System has maintained annual increases having renegotiated several large payer agreements with multi-year terms. The majority of the market continues to be self-funded with preferred provider organizations and point of service products still dominating sales to employers. The System is seeing more creativity and flexibility around networks and benefit structures within potential new health insurance offerings and the System feels it is in a strong position to participate in most, if not all, of these new offerings. However, the advent of the Federal health insurance exchange could create uncertainty in the private insurance market, as payers work to formulate and offer plans that comply with Federal requirements and that are also competitive and financially viable. Parallel relationships will continue to evolve with holding fee-for-service increases constant, while at the same time moving into new arrangements with reimbursement more dependent on quality, efficiencies and smaller networks driving additional patient volumes through the System. The System has focused contracting efforts on collaborative relationships with payers. These relationships include shared savings, performance based compensation, development/design of joint products, and shared to full risk arrangements.

The top five companies (Aetna U. S. Healthcare, Blue Cross and Blue Shield of Texas, United Healthcare, Cigna Healthcare of Texas, Inc., and the Health Plan) with which the System has managed care contracts accounted for 30.2% of gross patient revenue during fiscal year 2015. None of these companies accounted for more than 12.4% of total gross patient revenue. Several of the larger contracts have multiple-year terms with built-in price escalators based on inflation within the healthcare sector. However, the System's reliance on contracting with these companies could change, to the extent that Federal health insurance exchange participation evolves as consumers enter the marketplace.

The System May Be Adversely Affected by Competition

The System faces continued competition from other hospitals and other forms of health care delivery systems that offer health care services to the population it serves. Construction of or renovation of hospitals, ambulatory surgical centers and other ambulatory care facilities, free-standing emergency facilities, and private laboratory and radiological services could have an adverse impact on the market shares of System hospitals. In Texas, no certificates of need or similar state approvals are required to construct or expand health care facilities. Services such as home care, intermediate nursing home care, preventive care, ambulatory care and drug and alcohol treatment programs are increasingly being provided by alternative delivery systems. Alternative delivery systems have been encouraged by the changing policies of third party payers, both governmental and private. Third party payers have limited the payment rates for hospital stays and procedures, creating incentives that reduce hospital inpatient utilization and increase the use of outpatient services and out-of-hospital care.

Additionally, mergers or affiliations of existing competitors may create larger, more viable entities that may be more formidable competitors than the original constituent entities. While the effect of such action is uncertain, mergers and acquisitions can be expected to increase the level of competition faced by the System, and the utilization and revenues of the System could be adversely affected.

The ability to recruit and retain highly qualified physicians to a hospital's medical staff is one of the most significant factors in the competitive position of a hospital. Also, management's ability to negotiate service contracts with purchasers of group health care services is another major factor in the competitive position of a hospital. There can be no assurance that the impact of these factors on the System will not be adverse.

Technological advances in recent years have forced hospitals to acquire sophisticated and costly equipment to remain competitive. Moreover, the growth of e-commerce also may result in a shift in the way that health care is delivered, i.e. from remote locations. For example, physicians will be able to provide certain services over the internet and pharmaceuticals and other health services may now be purchased online. Additionally, other service providers in competition with the System may compete through these same electronic mediums by advertising their services and providing easy registration for competing services over the internet. If, due to financial constraints, lack of availability of equipment, or inability to obtain any necessary government approval, the System was less able to acquire new equipment or adapt to the shifting model of health care delivery required to remain competitive, the System could lose market share, and the financial condition of the System could be materially adversely affected.

Non-invasive interventions, including pharmacological treatments and gene therapy, are being developed at an increasing pace and could substantially reduce the demand for hospital services before the Series 2016A Bonds are retired. Unless population growth offsets this trend, or System hospitals are able to compensate by developing other services or reducing expenses, the financial condition of the System could be materially adversely affected by such medical advances.

The System May Be Adversely Affected By the Increasing Cost of Modern Technology

Scientific and technological advances, new procedures, drugs and devices, preventive medicine, occupational health and safety, and outpatient health care delivery may reduce utilization and revenues of the System in the future. Technological advances in recent years have accelerated the trend toward the use by hospitals of sophisticated and costly equipment and services, and the System may have to incur significant costs to acquire the equipment needed to maintain or enhance its competitive position. The acquisition and operation of certain equipment and services may continue to be a significant factor in hospital utilization, but the ability of the System to offer such equipment or services may be subject to the availability of equipment and specialists, governmental approval and the ability to finance such acquisitions and operations. The financial condition of the System could be materially adversely affected by such technological advances.

The System May Be Adversely Affected by Negative Reviews From Third Parties

Health plans, Medicare, Medicaid, employers, trade groups and other purchasers of health services, private standard-setting organizations and accrediting agencies increasingly are using statistical and other measures in efforts to characterize, publicize, compare, rank and change the quality, safety and cost of health care services provided by hospitals and physicians. Published rankings such as “score cards,” “pay for performance,” “never events” and other financial and non-financial incentive programs are being introduced to affect the reputation and revenue of hospitals and the members of their medical staffs to influence the behavior of consumers and providers. Currently prevalent are measures of quality based on clinical outcomes of patient care, reduction in costs, patient satisfaction and investment in health information technology. Measures of performance set by others that characterize the System negatively may adversely affect its reputation and the financial condition of the System.

The System’s Financial Results of Operation and Condition Could Be Adversely Affected By Future Acquisitions or Divestitures

As with many other healthcare systems, BSW Holdings selectively evaluates potential merger, joint venture, and affiliation opportunities on a continuing basis as part of its overall strategic planning and development process. Discussions with respect to affiliation, merger, acquisition, disposition, or change of use are held on an intermittent and confidential basis with other parties. As a result, the corporate structure and assets of the System could change from time to time.

No assurance can be given that completed affiliations will be permanent, even when they are originally intended to be or that any completed affiliation would not materially adversely affect the System’s financial condition or results of operations or result in a lower rating of the Series 2016A Bonds. Certain changes to the corporate structure or membership of the Combined Group will be subject to the provisions of the Master Indenture. See “**THE MASTER INDENTURE — Consolidation, Merger, Conveyance or Transfer**” and “**— Concerning the Obligated Affiliates**” in APPENDIX C.

As part of its ongoing planning and property management functions, BSW Holdings also reviews the use, compatibility and business viability of many of the operations and facilities of the System, and, from time to time, BSW Holdings may pursue changes in the use or disposition of such facilities. Dispositions of facilities are not limited by the Master Indenture. Likewise, BSW Holdings occasionally receives offers from or conducts discussions with third parties about the potential acquisition of operations or properties or the potential sale of some of their operations and properties.

If a proceeding were brought to dissolve BSW Holdings or a nonprofit BSW Holdings affiliate or to distribute its assets to other charitable donees, the Texas Attorney General may intervene and enter into a compromise, settlement, contract or judgment relating to the proceeding. The Attorney General is also authorized to bring suit against a nonprofit hospital for a breach of certain of its duties. If BSW Holdings or an affiliate proposed to merge or affiliate with a for-profit or out-of-state health care entity or take some other action which might have an adverse effect on the distribution of its charitable assets, the Attorney General might bring an action to prevent the merger or affiliation. This power could interfere with possible workout or liquidation proceedings and possibly have adverse effects on the financial condition of the System.

Unanticipated Catastrophes and Conditions Could Adversely Affect the System's Financial Condition and Results of Operations

Concentration Risks. The System's operations are limited to North and Central Texas, and a substantial amount of its revenue is realized from facilities in close proximity to the Dallas-Fort Worth-Arlington Metropolitan Statistical Area and the Killeen-Temple and Waco Metropolitan Statistical Areas. This concentration makes it particularly sensitive to regulatory, economic, environmental and competitive conditions and changes in the State of Texas. Any material change in the current payment programs or regulatory, economic, environmental or competitive conditions in that state could have a substantial effect on its overall business results. In addition, System facilities are located in areas prone to tornadoes. A hurricane, tornado, fire, earthquake, or other natural disaster could adversely affect the System, especially if insurance is inadequate to cover resulting property and business losses.

IT System Vulnerability. The System's operations are heavily dependent on the performance of its information technology ("*IT*") system. Its IT system is essential to financial accounting and reporting, proper billing and collecting, managing inventory, managing patient records, and complying with regulatory requirements, among other functions. In addition, recent legislation creates future financial incentives for health care providers to make more extensive use of electronic health records. Any IT system failure could adversely affect operations or delay the collection of revenues. Even though the System has implemented network security measures, its servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering. The occurrence of any of these events could result in interruptions, delays, the loss or corruption of data, or cessations in the availability of systems, all of which could have a material adverse effect on the System's financial position and results of operations and harm its business reputation. In addition, a breach of the System's IT system that results in a violation of the HIPAA security and privacy rules could result in damages or civil or criminal penalties, or increase operating expenses as necessary to notify affected individuals, correct problems, comply with federal and state regulations, defend against potential claims and implement and maintain any additional requirements imposed by government action.

Economic Recession and Disruptions to Credit Markets Could Adversely Affect the System

The disruption of the credit and financial markets in the last several years has led to volatility in the securities markets, significant losses in investment portfolios, increased business failures and consumer and business bankruptcies and is a major cause of the recent economic recession. The current economic climate has adversely affected the health care sector generally. Patient service revenues and inpatient volumes have not increased as historic trends would otherwise indicate. Until recently, unemployment rates were increasing nationally, which has resulted in increases in self-pay admissions, increased levels of bad debt and uncompensated care, unfavorable changes in payor mix, reduced demand for elective procedures, reduced availability and affordability of health insurance, and increased difficulty attracting philanthropy. The economic climate also increased stresses on state budgets, potentially resulting in reductions in Medicaid payment rates or Medicaid eligibility standards and delays in

payment of amounts due under Medicaid and other state or local payment programs. Any similar economic recession in the future could have similar or worse effects.

In response to that disruption, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “*Financial Reform Act*”) was enacted in July 2010. The Financial Reform Act includes broad changes to the existing financial regulatory structure, including the creation of new federal agencies to identify and respond to risks to the financial stability of the United States. Additional legislation is pending or under active consideration by Congress, and regulatory action is being considered by various federal agencies and the Federal Reserve Board and foreign governments, which are intended to increase the regulation of domestic and global credit markets. The effects of these legislative, regulatory and other governmental actions, including the Financial Reform Act and the BCA, upon the System and, in particular, upon its access to capital markets and its investment portfolios, cannot be predicted.

The System Could Be Limited By, or Incur Substantial Liability Under, Federal or State Laws

Antitrust Laws. Antitrust liability may arise in a wide variety of circumstances, including medical staff privilege disputes, third party contracting, physician relations, joint ventures, mergers, affiliations, acquisitions, and pricing and salary-setting activities. In some respects, the application of federal and state antitrust laws to health care is still evolving, and enforcement activity by federal and state agencies appears to be increasing. Violation of the antitrust laws could subject the System to criminal and civil enforcement by federal and state agencies, as well as by private litigants. In certain actions, private litigants may be entitled to treble damages, and, in others, government entities may be able to assess substantial monetary fines.

The ability to consummate mergers, acquisitions or affiliations may also be impaired by the antitrust laws, potentially limiting the ability of the System to fulfill its strategic plans. Liability in any of these or other antitrust areas of liability may be substantial, depending on the facts and circumstances of each case.

Environmental Laws and Regulations. Health care providers are subject to a wide variety of federal, state and local environmental and occupational health and safety laws and regulations that address, among other things, provider operations and facilities owned or operated by providers.

In their roles as owner and/or operator, BSW Holdings and its affiliates may be subject to liability for hazardous substances that are located on their property, including any such substances that may have migrated off their property. There can be no assurance that BSW Holdings and its affiliates will not incur such risks in the future, and any such risks may result in material adverse consequences to the operations or financial condition of the System.

Malpractice and Other Claims. If one or more substantial medical malpractice claims, or claims arising from the corporate or business activities of the System, are successfully brought against BSW Holdings or an affiliate in excess of insurance coverage, or if other actions are successfully brought seeking punitive or other damages which are not covered by insurance, the financial results and condition of the System would substantially and adversely be affected. For a discussion of the System’s current litigation, see “**OTHER INFORMATION — Litigation and Proceedings**” in **APPENDIX A** and the notes to audited consolidated financial statements in **APPENDIX B**. The System provides for professional liability insurance through a combination of trustee self-insurance reserves and excess indemnity policies. Should reserves be depleted to satisfy claims, required annual additions to reserves could increase substantially.

The System is Dependent on, and Could Incur Liability in Denying Access to, the Medical Staffs of its Hospitals

The operation of the System’s hospitals is dependent on their ability to recruit and retain highly qualified physicians to the hospitals’ medical staffs, and to encourage non-employed physicians to admit patients to those hospitals rather than to competing hospitals where they maintain privileges. System hospitals have a variety of relationships with physicians. Many of these relationships may be of material importance to the operations of System hospitals. In an increasingly complex legal and regulatory environment, these relationships pose a variety of

legal and business risks. For purposes of contracting with managed care organizations, physicians are organizing or joining physician practice groups or independent practice associations that are comprised of a large number of physicians. This consolidation increases the importance of attracting physicians in the groups to hospitals' medical staff and increases the risk of the loss of the physicians as a group.

The primary relationship between a hospital and physicians who practice at the hospital is through the hospital's organized medical staff. Medical staff bylaws, rules and policies establish the criteria and procedures by which the hospital will grant, restrict, deny or revoke a physician's medical staff membership and/or clinical privileges. Physicians whose medical staff membership or privileges are denied, restricted or revoked often file legal actions against the hospital. Such actions may include a wide variety of claims, some of which could result in substantial uninsured damages to a hospital. In addition, failure of the hospital governing body to oversee adequately the conduct of its medical staff may result in hospital liability. All hospitals are subject to such risks.

Hospitals regularly have disputes regarding credentialing and peer review and may be subject to liability in this area. In addition, hospitals occasionally indemnify medical staff members who are involved in such credentialing or peer review activities and may also be liable with respect to such indemnity. Exposure to this liability is mitigated by complying with requirements of the federal Health Care Quality Improvement Act ("*HCQIA*"). BSW Holdings intends for the System's peer review activities to result in HCQIA protection. Nonetheless, some activities are not HCQIA-protected, and there can be no assurance that material and adverse liability will not result.

Integrated Health Care Delivery

Many hospitals and health systems are pursuing strategies with physicians to offer an integrated package of health care services. Hospitals and hospital systems often own, control or have affiliations with relatively large physician groups. Generally, the sponsoring hospital or health system will be the primary capital and funding source for such alliances and may have an ongoing financial commitment to provide growth capital and support operating deficits. These types of alliances are generally designed to respond to trends in the delivery of medicine to better integrate hospital and physician care, to increase physician availability to the community or to increase the managed care capability of the affiliated hospitals and physicians. However, these goals may not be achieved, and an unsuccessful alliance may be costly and counterproductive.

The Reform Acts establish a Medicare Shared Savings Program ("*MSSP*") to promote accountability and coordination of care through the creation of ACOs. The Reform Acts also require the Secretary of HHS to implement a shared savings program that will allow providers, such as hospitals and physicians, to organize as ACOs, and to implement a voluntary demonstration project to develop ACOs for pediatric patients under the Medicaid program. To qualify as an ACO, organizations must agree to be accountable for the overall care of their Medicare beneficiaries, have adequate participation of primary care physicians, define processes to promote evidence-based medicine, report on quality and costs, and coordinate care. The program will allow hospitals, physicians and others to form ACOs and work together to invest in infrastructure and redesign integrated delivery processes to achieve high quality and efficient delivery of services. ACOs that achieve quality performance standards will be eligible to share in a portion of the amounts saved by the Medicare program. HHS has significant discretion to determine key elements of the program, including what steps providers must take to be considered an ACO, how to decide if Medicare program savings have occurred, and what portion of such savings will be paid to ACOs.

The ACO and MSSP final rules were published in November 2011 and June 2015; however, the regulations are complex and it remains unclear whether the qualification requirements will be a formidable barrier to entry. In particular, because the federal ACO regulations do not preempt state law, providers in any state participating as a federal ACO must be organized and operated in compliance with such state's existing statutes and regulations. In January 2016, CMS issued a proposed rule that aims to revise the benchmark rebasing calculations for ACOs. While these revised benchmark rebasing calculations may be particularly attractive for high performing ACOs, the delayed onset of these revised benchmark calculations (e.g., the revised methodology would not apply for the earliest ACOs until the start of their third participation agreement in 2019) leaves the MSSP ACO landscape somewhat uncertain. Also, the Federal Trade Commission ("*FTC*") and Department of Justice ("*DOJ*") issued a joint statement of

antitrust enforcement policy in October 2011 as applied to ACOs; CMS and the OIG issued a final rule in October 2015 on certain waivers of the Anti-kickback Statute, Stark law and the Civil Money Penalty laws for ACOs; and the IRS issued a notice and fact sheet in October 2011 addressing the impact on tax-exempt organizations participating in ACOs; however, there may remain regulatory risks for participating hospitals, as well as financial and operational risks. It is possible that hospital participants in ACOs will have to marshal a large upfront financial investment to form unique and untested ACO structures, which may or may not succeed in gaining qualification. For those that do qualify, it is uncertain whether the savings will be adequate to recoup the initial investment.

The System May Not Be Able to Employ an Adequate Workforce on Affordable Terms

Hospitals are large employers with a wide diversity of employees. Increasingly, employees of hospitals are becoming unionized, and many hospitals have collective bargaining agreements with one or more labor organizations. Employees subject to collective bargaining agreements may include essential nursing and technical personnel, as well as food service, maintenance and other trade personnel. Although neither BSW Holdings nor any of its controlled affiliates has ever been a party to a collective bargaining agreement, practices could change in the future. To the extent a significant portion of the System's employee base unionizes, it is possible its labor costs could increase materially.

A significant national nursing shortage exists, impacting patient care and labor costs. System hospitals have taken recruiting and retention steps to maintain an adequate, effective professional nursing staff. There can be no assurance that the national nursing shortage will not affect the System in the future. To attract adequate staff, the System may be required to continue to enhance wages and benefits or to hire more expensive temporary or contract personnel. As a result, its labor costs could increase.

Similar to other healthcare systems, a significant percentage of the System's revenues consist of fixed, prospective payments. Its ability to pass along increased labor costs is contingent upon successful negotiation of commercial contracts and inflationary increases provided by fixed payers. Any failure to recruit and retain qualified management, nurses and other medical support personnel, or to control labor costs, could have a material, adverse effect on its results of operations.

Additionally, a U.S. Supreme Court decision expanded employers' potential liability for workplace retaliation claims brought by employees under Title VII. This decision exposes employers to a broader array of retaliation claims and makes those claims more difficult to defend.

An additional area of economic exposure for employers, including health care providers, is misclassification of workers as independent contractors, rather than employees. If a worker is classified as an employee, the employer pays certain taxes based upon the amounts earned by the employee. Independent contractors, however, bear the entire economic burden of such taxes by paying self-employment taxes. Consequently, if an employer classifies a worker as an independent contractor and the IRS subsequently reclassifies the worker as an employee, the employer is liable for all taxes the employer otherwise would have paid to the IRS. Although a single misclassification may not have a material adverse effect on the System, a number of misclassifications over a period of time, together with any resulting penalties, may have an adverse financial impact. Moreover, the IRS has taken a broad view of the relations between hospitals and physicians that require hospitals to pay employment tax for certain amounts paid to physicians. Accordingly, the System might be broadly liable for employment taxes for contract payments made to physicians. Such liability could have a material adverse effect on the financial condition of the System.

System Affiliates or the Series 2016A Bonds Could Lose Their Tax-Exempt Status

Tax-Exempt Status of Interest on the Series 2016A Bonds. The Code imposes a number of requirements that must be satisfied for interest on state and local obligations, such as the Series 2016A Bonds, to be excludable from gross income for federal income tax purposes. These requirements include limitations on the use of bond proceeds, limitations on the investment earnings of bond proceeds prior to expenditure, a requirement that certain investment earnings on bond proceeds be paid periodically to the United States, and a requirement that the issuers file an information report with the IRS. BSW Holdings has agreed that it will, and that it will cause its controlled

affiliates to, comply with such requirements. Failure to comply with the requirements stated in the Code and related regulations, rulings and policies may result in the treatment of the interest on the Series 2016A Bonds as taxable. Such adverse treatment may be retroactive to the date of issuance. See also “**TAX EXEMPTION**” below.

Neither the Issuer nor BSW Holdings has sought to obtain a private letter ruling from the IRS with respect to the exempt status of interest on the Series 2016A Bonds, and the opinion of Norton Rose Fulbright US LLP is not binding on the IRS. There is no assurance that any IRS examination of the Series 2016A Bonds will not adversely affect the market value of the Series 2016A Bonds. See “**TAX EXEMPTION**” below.

Tax-Exempt Status of System Affiliates. The tax-exempt status of the Series 2016A Bonds presently depends upon maintenance by BSW Holdings and certain other affiliates of their status as organizations described in Section 501(c)(3) of the Code. The maintenance of this status depends on compliance with general rules regarding the organization and operation of tax-exempt entities, including their operation for charitable and educational purposes and their avoidance of transactions that may cause their earnings or assets to inure to the benefit of private individuals, such as the private benefit and inurement rules. The IRS has recently expanded tax return forms for exempt organizations to include information on outstanding bonds and how much community benefit is provided.

Tax-exempt organizations are subject to scrutiny from and face the potential for sanctions and monetary penalties imposed by the IRS. If a tax-exempt entity is engaged in private inurement or impermissible private benefit, the IRS may revoke its tax-exempt status. Although the IRS has not frequently revoked the tax-exempt status of nonprofit hospitals, it could do so in the future. If BSW Holdings or another benefited affiliate were to lose its tax-exempt status, defaults in covenants regarding the Series 2016A Bonds and other obligations of the Obligated Affiliates would likely be triggered and the Obligated Affiliates could incur substantial tax liabilities on their income. For these reasons, any loss of the tax-exempt status of BSW Holdings or any of its affiliates could materially adversely affect the financial condition of the System.

With increasing frequency, the IRS has imposed substantial monetary penalties and future charity care or public benefit obligations on tax-exempt hospitals in lieu of revoking their tax-exempt status, as well as requiring that certain transactions be altered, terminated or avoided in the future and/or requiring governance or management changes. These penalties and obligations are typically imposed on the tax-exempt hospital pursuant to a “closing agreement,” a contractual agreement pursuant to which a taxpayer and the IRS agree to settle a disputed matter. Given the exemption risks involved in certain transactions, BSW Holdings and its exempt affiliates may be at risk for incurring monetary and other liabilities imposed by the IRS. These liabilities could be materially adverse.

Less onerous sanctions, referred to generally as “intermediate sanctions,” have been enacted, which sanctions focus enforcement on private persons who transact business with a tax-exempt organization rather than the tax-exempt organization itself, but these sanctions do not replace the other remedies available to the IRS mentioned above.

Certain Obligated Affiliates and their controlled affiliates have entered into joint ventures with for-profit parties for the ownership and operation of certain medical facilities. The rules applicable to such joint ventures are complex, and while BSW Holdings believes that all of its affiliated joint ventures are in compliance with such rules currently, any change in or violation of the applicable rules could adversely affect the tax-exempt status of one or more Obligated Affiliates as an organization or organizations described in Section 501(c)(3) of the Code. Such a change or violation may also require the dissolution of one or more joint ventures, which could have material adverse consequences to the Combined Group.

BSW Holdings or one or more affiliates may be audited by the IRS. Because of the complexity of the tax laws and the presence of issues about which reasonable persons can differ, an IRS audit could result in additional taxes, interest and penalties. An IRS audit ultimately could affect the tax-exempt status of BSW Holdings or one or more affiliates, as well as the exclusion from gross income for federal income tax purposes of the interest on the Series 2016A Bonds and other tax-exempt debt issued for BSW Holdings and its exempt affiliates.

The IRS Form 990 is used by most organizations exempt from federal income taxation under Section 501(c)(3) of the Code. The IRS Form 990 requires detailed public disclosure of compensation practices, corporate

governance, loans to executive management and others, joint ventures and other types of transactions, political campaign activities, and other areas the IRS deems to be compliance risk areas. Under the Reform Acts, the IRS Form 990 has been expanded for tax-exempt hospitals to report on new Code Section 501(r) requirements. The Reform Acts contain new requirements for tax-exempt hospitals. Under the Reform Acts, each tax-exempt hospital facility is required to (1) conduct a community health needs assessment at least every three years and adopt an implementation strategy to meet the identified community needs; (2) adopt, implement and widely publicize a written financial assistance policy and a policy to provide emergency medical treatment without discrimination; (3) limit charges to individuals who qualify for financial assistance under the hospital's financial assistance policy to no more than the amounts generally billed to individuals who have insurance covering such care and refrain from using "gross charges" when billing such individuals; and (4) refrain from taking extraordinary collection actions without first making reasonable efforts to determine whether the individual is eligible for assistance under the hospital's financial assistance policy. In addition, under the Reform Acts, the Treasury Department is required to review information about a hospital's community benefit activities at least once every three years. In recent years legislation has been proposed to repeal the exemption of nonprofit hospitals from federal income taxes. The Reform Acts may make it more difficult to comply with community benefit requirements. Any reduction in community benefits provided by nonprofit hospitals generally could increase the risk of passage of such legislation.

Effective for tax years beginning after March 23, 2010, Schedule H to the IRS Form 990 asks whether a 501(c)(3) organization has a charity care policy and requests a description of that policy. Schedule H also requires that an organization report the community benefits that it provides, including the cost of providing charity care and other benefits. The reporting of this information to the IRS could lead to additional audit examinations and a more stringent interpretation by the IRS of community benefit.

Schedule K to the IRS Form 990 is intended to address what the IRS believes is significant noncompliance by tax-exempt organizations with recordkeeping and record retention requirements relating to their outstanding tax-exempt bonds. Schedule K requires substantial additional efforts on the part of many tax-exempt organizations to complete. Schedule K also focuses on the investment of bond proceeds that could violate the arbitrage rebate requirements and on the private use of bond-financed facilities. The new IRS Form 990 provides additional detailed information to the IRS, as well as to states' attorneys general, unions, plaintiff class action lawyers and public interest groups, that is likely to result in increased enforcement actions, the effect of which cannot be determined at this time.

State and Local Tax Exemption. In recent years, state, county, and local taxing authorities have been undertaking audits and review of the operations of tax-exempt health care providers with respect to their property tax exemption for both real and personal property. Recent reviews have been conducted by local appraisal districts and have focused on large healthcare systems. The majority of the System's real and personal property is currently exempt from property taxes. Investigations or audits could lead to challenges of the property tax exemption with respect to facilities that, if successful, could adversely and materially affect the property tax exemption with respect to certain of the System's facilities or property.

It is not possible to predict the scope or effect of future legislative or regulatory actions with respect to taxation of nonprofit corporations. There can be no assurance that future changes in the laws and regulations of federal, state or local governments will not materially adversely affect the operations and financial condition of the System by requiring BSW Holdings or any of its affiliates to pay income or local property taxes.

Unrelated Business Taxable Income. The IRS and state, county and local taxing authorities may undertake audits and reviews of the operations of tax-exempt hospitals with respect to the generation of unrelated business taxable income ("***UBTI***"). BSW Holdings and its tax-exempt affiliates participate in activities that may generate UBTI. The level of these activities is currently immaterial to the System as a whole, but these activities could increase in the future. An investigation or audit could lead to a challenge that could result in taxes, interest and penalties with respect to UBTI and, in some cases, ultimately could affect the tax-exempt status of BSW Holdings or its tax-exempt affiliates, as well as the exclusion from gross income for federal tax purposes of the interest payable on the Series 2016A Bonds and other tax-exempt debt issued for BSW Holdings and its exempt affiliates.

The System Could Be Adversely Affected By Providing Too Much, or Too Little, Uncompensated Care to Indigents

Tax-exempt hospitals often treat large numbers of indigent patients who are unable to pay for their medical care. These hospitals may be susceptible to economic and political changes that could increase the number of indigents or the hospitals' responsibility for caring for this population. General economic conditions that affect the number of individuals who have health coverage affects the ability of patients to pay for their care. Similarly, changes in governmental policy, which may result in coverage exclusions under local, state and federal health care programs (including Medicare and Medicaid), may increase the frequency and severity of indigent treatment in such hospitals.

Under Texas law, non-profit hospitals must provide charity care and government sponsored indigent health care in an amount (i) determined through a community needs assessment, based on available resources of the hospital and the tax-exempt benefits received by the hospital; (ii) equal to at least 100% of the hospital's tax-exempt benefits (excluding federal income tax exemptions) or (iii) equal to at least 5% of the hospital's net patient revenue, provided that charity care and government-sponsored indigent health care are provided in an amount equal to at least 4% of the hospital's net patient revenue. Hospitals that qualify as disproportionate share hospitals are deemed to satisfy the requirements. Noncompliance with the charity care requirements may result in the loss of property, franchise and sales tax exemptions, which would have a material adverse effect on the financial condition of the System.

It is possible that future legislation or court decisions could require that tax-exempt organizations that own and operate hospitals maintain defined minimum levels of indigent care as a condition to federal income tax exemption or exemption from certain state or local taxes. In the event that there are changes to hospital charity and indigent care obligations, there could be a material and adverse effect on the operations or financial condition of the System.

The System Could Lose Accreditation or Licenses

Health care facilities, including those operated by the System, are subject to the requirements of numerous governmental, licensing, certification and accreditation authorities. These include, but are not limited to, the Medicare and Medicaid programs, state licensing agencies, private payers, The Joint Commission, and other accrediting organizations. Renewal and continuation of certain of these licenses, certifications and accreditations are based on inspections, surveys, audits, investigations or other reviews, some of which may require or include affirmative activity or response by the System. In addition, to maintain Medicare certification, providers must meet CMS's "Conditions of Participation" ("*COPs*") on an ongoing basis, as determined by each state in which they operate; however, certain providers that hold an accreditation from a CMS-approved accreditation program, such as The Joint Commission, may be exempt from state surveys. These activities generally are conducted in the normal course of business of health care facilities. Nevertheless, an adverse result could cause a loss or restriction in licensure, certification or accreditation, reduce payments, result in loss of eligibility to participate in the Medicare program, or require repayment of amounts previously remitted to the provider. Accordingly, an adverse result could have a material and adverse effect on the operations or financial condition of the System.

340B Drug Pricing Program

On August 28, 2015, the federal Health Resources and Services Administration ("*HRSA*") published proposed omnibus guidance for the 340B Drug Pricing Program. Under the program, drug manufacturers are required to provide outpatient drugs to eligible health care organizations at significantly reduced prices. The guidance includes proposals to, among other things, (i) narrow the definition of patients who are eligible to receive 340B discounted drugs, (ii) exclude patients receiving infusion services from 340B eligibility if the only health care services received by the patient are infusion services, and (iii) change the definition of "covered outpatient drug" such that outpatient drugs that are part of a bundled payment for Medicaid reimbursement would not qualify for 340B drug discounted pricing. The American Hospital Association and other trade groups have issued public comments stating that the proposed guidance could reduce the volume of drugs eligible for 340B drug discount pricing and increase the cost of drugs to hospitals and other health care organizations. HRSA collected comments

on the proposed omnibus guidance from the general public through October 27, 2015. The agency has not announced when it expects to issue its final guidance.

The System's Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds

Interest Rate Swaps. BSW Holdings, BHCS and S&W have entered into interest rate swap transactions. The transactions may have a substantial negative value to the System from time to time. The swap counterparties may be able to terminate the transactions upon certain events of default or similar termination events thereunder or, under certain transactions, if the long-term senior unsecured unenhanced debt ratings of the System are withdrawn, suspended or reduced below specified levels. If a swap counterparty or BSW Holdings, BHCS and S&W terminates a transaction when it has a negative value to BSW Holdings, BHCS or S&W, then BSW Holdings, BHCS or S&W would be required to make a termination payment to the counterparty, and the payment could be substantial. Moreover, for certain transactions BSW Holdings, BHCS, or S&W are required to deliver collateral to the counterparty from time to time to secure all or a portion of its contingent termination obligations, and the amount of collateral required to be delivered could be substantial. As of February 29, 2016, \$24.7 million in collateral was required to be posted. If a swap transaction is terminated and BSW Holdings, BHCS or S&W is unable to replace the transaction, it could thereafter be exposed to higher unhedged variable interest rates, or to a higher fixed rate if it converts or refinances the hedged bonds.

Certain interest rate swap transactions entered into by BSW Holdings, BHCS and S&W expose the System to basis risk, because the interest rate on the hedged bonds generally reflects the interest rate on short-term tax-exempt bonds and market perception of the credit of the System and third-party liquidity providers, whereas the floating rate payments to be made under the transaction are determined pursuant to a formula based on a taxable short-term interest rate index. If the relationship between short-term taxable and tax-exempt interest rates changes, or if the hedged bonds trade at higher interest rates than short-term tax-exempt bonds generally, or if a counterparty fails to timely perform in full its obligations under a transaction, the System may be exposed to basis risk, the amounts received from the applicable counterparties under the transaction may be less than the total interest cost of the hedged bonds, and the differences could be substantial.

Certain interest rate swap transactions entered into by BSW Holdings, BHCS and S&W currently are not associated with any variable rate debt of the System. These transactions expose the System to the difference between the floating rate and fixed rate exchanged in the transactions. In addition, the System is susceptible to credit risk based on the credit of the swap counterparties on its interest rate swap transactions. A default by a swap counterparty could reduce the amount of funds available to pay principal and interest on Master Debt. See “**FINANCIAL INFORMATION — Interest Rate Swap Transactions**” in **APPENDIX A**.

Demand Obligations. After the issuance of the Series 2016A Note, approximately \$45.12 million aggregate principal amount outstanding of the Master Debt will become due upon expiration or termination of the short-term liquidity facilities obtained to purchase related bonds that are tendered for purchase but not remarketed if BSW Holdings is unable to extend or replace such liquidity facilities. If BSW Holdings is unable to extend, refund or replace such facilities in the future, it could be required to refinance such Master Debt at substantially higher interest rates than those assumed for such Master Debt herein. If it fails to do so, available cash and investments could be reduced to pay the principal of such Master Debt.

In addition, if any of the Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds (Baylor Health Care System Project) Series 2011B (the “**Series 2011B Bonds**”) or Series 2013B (the “**Series 2013B Bonds**”), which together aggregate \$95,000,000 in principal amount and for which no liquidity facility will be in place, are tendered for purchase and are not able to be remarketed, then BHCS will be obligated to purchase such Series 2011B Bonds or Series 2013B Bonds. If such Series 2011B Bonds or Series 2013B Bonds are tendered for purchase and are not able to be remarketed, available cash and investments of the System could be reduced to pay the purchase price of such Series 2011B Bonds or Series 2013B Bonds.

Certain debt secured by Master Debt, which aggregates \$615.415 million in principal amount and for which no liquidity facility will be in place, is subject to mandatory tender in 2017 through 2025, as applicable, with an obligation of BSW Holdings to repay such debt in 2018 through 2026 (each, a “**Mandatory Purchase Date**”) if such

debt is not able to be remarketed or refinanced. Also, upon occurrence of certain events contained in agreements with the holders of such debt, such debt may be required to be redeemed before each respective Mandatory Purchase Date. If such debt is so tendered for purchase and is not able to be remarketed and is not refinanced, available cash and investments of the System could be reduced to pay such debt.

Covenants. Financial agreements to which Obligated Affiliates are a party contain various covenants that limit their ability to engage in specified types of transactions. They could impede the ability of the Obligated Affiliates to realize cash flows sufficient to pay the Master Debt or maintain the ratings assigned to the Series 2016A Bonds and their value. The agreements require the Obligated Affiliates to satisfy and maintain specified financial ratios and meet certain other tests. The ability of the Obligated Affiliates to meet those financial ratios can be affected by events beyond their control, and there can be no assurance they will continue to meet those ratios or tests. A breach of any of these covenants could result in a default under the Master Indenture and credit and liquidity agreements with banks. Upon an event of default under any of these agreements, creditors of the Obligated Affiliates could elect to declare all outstanding advances immediately due and payable and terminate all commitments to extend further credit. Any such action could reduce cash available to pay the Master Debt, or could result in an acceleration of the due date for the Series 2016A Bonds without the consent of their owners.

The Master Debt is not Secured by any Pledge or Security Interest and there is no limitation on future Master Debt under the Master Indenture

The obligations of the Combined Group under the Master Indenture are not secured by any revenues of any member of the System, and such obligations may be affected by various matters, including (i) federal bankruptcy laws and other creditors' rights laws, (ii) rights of third parties in cash, securities and instruments not in possession of the Master Trustee, including accounts and general intangibles converted to cash, (iii) rights arising in favor of the United States of America or any agency thereof, (iv) present or future prohibitions against assignment in any federal statutes or regulations, (v) constructive trusts, equitable liens or other rights impressed or conferred by any state or federal court in the exercise of its equitable jurisdiction and rights of donors of property, (vi) claims that might obtain priority if a security interest or lien is not granted or continuation statements are not filed in accordance with applicable laws, (vii) the rights of holders of prior perfected security interests in equipment and other goods owned by the Combined Group Members and in the proceeds of sale of such property, (viii) statutory liens, and (ix) the rights of parties secured by permitted liens. If an event of default does occur, it is uncertain that the Master Trustee could successfully obtain an adequate remedy at law or in equity on behalf of the owners of the Series 2016A Bonds. In addition, obligations other than the Series 2016A Bonds and other outstanding Master Debt may be issued from time to time in the future pursuant to the Master Indenture without limitation, and such obligations will be on a parity with the Series 2016A Bonds with respect to the benefits of the Master Indenture. In addition, should other entities become Obligated Affiliates in the future, the current other Obligated Affiliates would become jointly and severally liable for any obligations issued on behalf of such entities under the Master Indenture.

No facilities are pledged as security for the Series 2016A Bonds. In addition, little property of BSW Holdings and its affiliates consists of general purpose buildings suitable for industrial or commercial use. Consequently, it could be difficult to find a buyer or lessee for the property, and, upon a default, the Master Trustee may not obtain an amount equal to the aggregate liabilities of the Obligated Affiliates (including liabilities in respect of the defaulted Series 2016A Bonds then outstanding) from the sale or lease of the property, whether pursuant to a judgment against any Obligated Affiliate or otherwise.

The Master Indenture permits Obligated Affiliates to incur purchase and construction money debt and to secure the debt with a lien on the property acquired or improved without limitation. If they exercise that right, any claims against such property to satisfy the Obligated Affiliates' obligations on the Series 2016A Bonds would be subordinate to the payment of such debt.

Other indebtedness of certain affiliates of BSW Holdings is, and future indebtedness of BSW Holdings or its affiliates may be, secured by liens on the property of such persons. The Obligated Affiliates and any future Restricted Affiliates covenant to comply with the restrictions in the Master Indenture on the incurrence of liens. See "**THE MASTER INDENTURE — Limitations on Liens**" in APPENDIX C. However, the utility of such covenant is limited because (a) there is no limitation on the ability of the Obligated Affiliates or future Restricted

Affiliates to transfer or dispose of assets in their entirety and, (b) so long as no Event of Default exists under the Master Indenture, any future Restricted Affiliate can be released from its obligations under the Master Indenture.

There is no limitation under the Master Indenture on the ability of the Obligated Affiliates or any future Restricted Affiliate to incur unsecured debt.

The Contractual Undertakings of the Obligated Affiliates May Not Be Fully Enforceable

In determining whether various covenants and tests contained in the Master Indenture are met, the accounts of BSW Holdings and its affiliates (whether or not such affiliates are Obligated Affiliates or Restricted Affiliates) may be combined. In addition, there are uncertainties as to the enforceability of certain obligations of the Obligated Affiliates contained in the Master Indenture which could bear on the availability of the revenues of the members of the Combined Group for payment of debt service on the Series 2016A Bonds, as further described below.

The joint and several obligations described herein of the Obligated Affiliates and any future Obligated Affiliates and the obligations of any future Restricted Affiliates to transfer funds to the Obligated Affiliates or any future Obligated Affiliate to make payments of debt service on the Series 2016A Bonds issued pursuant to and under the Master Indenture, the proceeds of which were not made available to such Obligated Affiliate or any future Restricted Affiliate, may not be enforceable to the extent that such payments (i) will be made on the Series 2016A Bonds issued for a purpose that is not consistent with the charitable purposes of the entity from which such payment is requested or which is issued for the benefit of any entity other than a tax-exempt organization; (ii) will be made from property that is donor restricted or that is subject to a direct or express trust that does not permit the use of such property for such payments; (iii) would result in the cessation or discontinuation of any material portion of the health care or related services previously provided by the entity from which such payment is requested; or (iv) will be made pursuant to any loan violating applicable usury laws. Due to the absence of clear legal precedent in this area, the extent to which the property of the Obligated Affiliate or any future Obligated Affiliate or any future Restricted Affiliate falls within category (ii) referred to above cannot be determined and could be substantial.

Any future Restricted Affiliate may not be required to transfer funds to the Obligated Affiliates or any future Obligated Affiliate to make payments on the Series 2016A Bonds to the extent that any such payment or transfer would render such paying entity insolvent or would conflict with, not be permitted by or would be subject to recovery for the benefit of other creditors of such entity under applicable fraudulent conveyance, bankruptcy, insolvency, moratorium or other similar laws affecting the enforcement of creditors' rights. There is no clear precedent in the law as to whether payments by the Obligated Affiliates or any future Obligated Affiliate on the Series 2016A Bonds issued by or for the benefit of another entity or transfers of funds by any future Restricted Affiliate for such purposes may be voided by a trustee in bankruptcy in the event of a bankruptcy of the Obligated Affiliates or any future Obligated Affiliate or any future Restricted Affiliate or by third party creditors in an action brought pursuant to fraudulent transfer statutes of the State of Texas. Under the United States Bankruptcy Code, a trustee in bankruptcy and, under fraudulent conveyances statutes of the State of Texas, a creditor of a related guarantor may avoid any obligation incurred by a related guarantor, if, among other bases therefor, (i) the guarantor has not received fair consideration or reasonably equivalent value in exchange for the guaranty, and (ii) the guaranty renders the guarantor insolvent, as defined in the United States Bankruptcy Code or fraudulent transfers statutes of the State of Texas, or the guarantor is undercapitalized.

Application by courts of the tests of "insolvency," "reasonably equivalent value" and "fair consideration" has resulted in a conflicting body of case law. It is possible that, in an action to force the Obligated Affiliates or any future Obligated Affiliate to pay debt service on any Master Debt issued by or for the benefit of another entity, or to force a Restricted Affiliate to transfer funds for such purpose, a court might not enforce such obligation in the event it is determined that such paying entity is analogous to a guarantor and that fair consideration or reasonably equivalent value for such guaranty was not received and that the incurrence of such obligation has rendered and will render the paying entity insolvent or the paying entity is or will thereby become undercapitalized.

The rights of the Master Trustee to take certain actions in the event of default by BSW Holdings are subject to the provisions of the Master Indenture. Generally, the holders of specified percentages of Controlling Master Debt may direct the Master Trustee in the event of certain defaults by the Obligated Affiliates. Holders of Master

Debt vote based upon the principal amount of Master Debt they hold or as otherwise described in **APPENDIX C**. After the issuance of the Series 2016A Note and the Taxable Bonds, the Series 2016A Note will comprise approximately 13% in aggregate principal amount of the outstanding Master Debt (exclusive of Master Debt relating to (a) bank loans for which no funds have been advanced, (b) credit and liquidity support for outstanding put debt for which no funds are owed and (c) interest rate swaps for which no funds are owed).

BSW Holdings or its Affiliates Could Seek Protection from Bankruptcy Laws That May Limit Rights of Certain Creditors

The legal right and practical ability of the Master Trustee to enforce rights and remedies under the Master Indenture may be limited by laws relating to bankruptcy, insolvency, reorganization, fraudulent conveyance or moratorium and by other similar laws affecting creditors' rights. Enforcement of such rights and remedies may require judicial actions that are subject to discretion and delay, that otherwise may not be readily available or that may be limited by certain legal principles.

In the event of bankruptcy of BSW Holdings or any of its affiliates, the rights and remedies of the holders of the Series 2016A Bonds are subject to various provisions of the federal Bankruptcy Code. If BSW Holdings or its affiliates were to file a petition in bankruptcy, payments made by BSW Holdings or affiliates during the 90-day (or perhaps one-year) period immediately preceding the filing of such petition may be voidable as preferential transfers to the extent such payments allow the recipients to receive more than they would have received in the event of any such debtor's liquidation. Security interests and other liens granted to the Master Trustee and perfected during such preference period also may be voided as preferential transfers to the extent such security interest or other lien secures obligations that arose prior to the date of such perfection. Such a bankruptcy filing would operate as an automatic stay of the commencement or continuation of any judicial or other proceeding against BSW Holdings or such affiliate and its property and as an automatic stay of any act or proceeding to enforce a lien upon or to otherwise exercise control over its property as well as various other actions to enforce, maintain or enhance the rights of the Master Trustee. If the Bankruptcy Court so ordered, the property of BSW Holdings or its affiliates, including accounts receivable and proceeds thereof, could be used for the financial rehabilitation of any of the affiliates despite any security interest of the Master Trustee therein. The rights of the Master Trustee to enforce any security interests it may have could be delayed during the pendency of the rehabilitation proceeding.

If BSW Holdings or any of its affiliates becomes the subject of a bankruptcy petition, it could file a plan of reorganization for the adjustment of its debts, which could include provisions modifying or altering the rights of creditors generally or any class of them, secured or unsecured. The plan, when confirmed by a court, binds all creditors who had notice or knowledge of the plan and, with certain exceptions, discharges all claims against the debtor to the extent provided for in the plan. No plan may be confirmed unless certain conditions are met, among which are conditions that the plan is feasible and that it shall have been accepted by each class of claims impaired thereunder. Each class of claims has accepted the plan if at least two-thirds in dollar amount and more than one-half in number of the class cast votes in its favor. Even if the plan is not so accepted, it may be confirmed if the court finds that the plan is fair and equitable with respect to each class of non-accepting creditors impaired thereunder and does not discriminate unfairly. Moreover, there is no assurance that certain covenants, including tax covenants, contained in the Loan Agreement or other documents would survive. Accordingly, the Obligated Affiliates or BSW Holdings or its affiliates as debtors in possession or a bankruptcy trustee appointed by the Bankruptcy Court could take action that would adversely affect the exclusion of interest on the Series 2016A Bonds from gross income for federal income tax purposes.

The various legal opinions delivered concurrently with the issuance of the Series 2016A Bonds are qualified as to the enforceability of the various legal instruments by limitations imposed by state and federal laws, rulings, policies and decisions affecting remedies and by bankruptcy, reorganization or other laws of general application affecting the enforcement of creditors' rights or the enforceability of certain remedies or document provisions.

BSW Holdings may be Limited in its Ability to Control Members of the System

At the time the Series 2016A Bonds are issued, BSW Holdings, BSW Health, BHCS, S&W, Baylor University Medical Center, Baylor All Saints Medical Center, Scott & White Memorial Hospital, Baylor Regional Medical Center at Grapevine, Baylor Medical Center at Waxahachie, Baylor Regional Medical Center at Plano, Baylor Medical Centers at Garland and McKinney, Scott & White Clinic, Scott & White Hospital – Round Rock, Scott & White Continuing Care Hospital, Scott & White Hospital – College Station and Hillcrest Baptist Medical Center will be the only Obligated Affiliates under the Master Indenture and, thus, the only entities that are obligated to pay the debt service on the Series 2016A Bonds.

It is possible, however, that the Obligated Affiliates will be dependent upon the results of operations of the other members of the System to generate sufficient available cash flow to pay the debt service on the Series 2016A Bonds. In such event, the Obligated Affiliates would be dependent upon such affiliates to transfer the necessary funds to or for the account of BSW Holdings in order to accomplish such payment.

Any such contributions from members of the System which may be necessary to pay the debt service on the Series 2016A Bonds may be in excess of the amounts advanced by BSW Holdings to such affiliates. Although BSW Holdings or other controlled affiliates of BSW Holdings, with certain exceptions, control the governing board of those members of the System, there are limitations on the ability of the Obligated Affiliates to cause members of the System to contribute funds to BSW Holdings. Nonprofit affiliates of BSW Holdings are not permitted to pay dividends to BSW Holdings and any gift or contribution from such an entity to the Obligated Affiliates could be subject to challenge by a creditor of the affiliate in question.

There is no guarantee that the Obligated Affiliates would be able to effectively exercise their powers of control relative to members of the System so as to cause such entities to make contributions of funds to BSW Holdings in amounts sufficient to pay the debt service on the Series 2016A Bonds.

The economic strength of the Obligated Affiliates will be affected by the economic strength of the other members of the System, none of which is now a Restricted Affiliate. The Master Indenture does not impose restrictions on the members of the System that are not Restricted Affiliates.

The Master Indenture Contains No Restriction on the Ability of the Combined Group to Transfer Assets

The Master Indenture imposes no restriction on the ability of any member of the Combined Group to transfer assets, including cash, to Persons within or outside the Combined Group. While BSW Holdings does not currently contemplate material transfers of assets to any Person outside the System, no assurance can be given that material transfers of assets, including cash, will not be made to Persons outside the System, or that such transfers, if made, would not adversely affect the System's financial condition and results of operations.

BSW Holdings and the Other Obligated Affiliates May Enter into a New Replacement Master Indenture

BSW Holdings and the other Obligated Affiliates have the ability to cause the Master Trustee to accept the substitution of a Replacement Master Indenture for the Master Indenture upon the satisfaction of certain conditions and financial tests. Other entities not in the Combined Group may be parties to the Replacement Master Indenture. No assurance can be given that the combined group under the Replacement Master Indenture will not be different from the Combined Group under the Master Indenture, or that the financial condition or results of operations of the combined group under the Replacement Master Indenture will not be materially different. See “**SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2016A BONDS — The Master Indenture — Replacement Master Indenture**” herein, and “**APPENDIX C — THE MASTER INDENTURE — Replacement Master Indenture**.”

BSW Holdings and the Other Obligated Affiliates May Permit Additional Obligated Affiliates under the Master Indenture

Additional entities may become Obligated Affiliates under the Master Indenture upon the satisfaction of certain conditions. Prior to a new entity becoming an Obligated Affiliate, BSW Holdings is required to provide the Master Trustee with a certificate establishing (i) that no Default or Event of Default under the Master Indenture would occur as a result of such transaction, and (ii) (a) that the Consolidated Net Revenues of the Combined Group following the proposed transaction would not be less than 150% of the Maximum Annual Debt Service Requirements of the Obligated Affiliates or (b) that the unrestricted net assets of the Obligated Affiliates immediately after the proposed transaction will be at least equal to 70% of the unrestricted net assets of the Obligated Affiliates immediately prior to the proposed transaction, based on Financial Statements for the most recent Fiscal Year. There can be no assurance that any such admission would not materially adversely affect the Combined Group's financial condition See “**APPENDIX C — THE MASTER INDENTURE — Concerning the Obligated Affiliates.**”

The Master Indenture, Bond Indenture and Loan Agreement Could Be Amended Without Bondholder Consent

Certain amendments to the Master Indenture may be made with the consent of the holders of not less than a majority of the principal amount of Master Debt outstanding under the Master Indenture. Such percentage may be composed wholly or partially of the Holders of Master Debt other than the Series 2016A Notes. Certain amendments to the Bond Indenture and the Loan Agreement may be made with the consent of the holders of not less than a majority of the outstanding principal amount of the Series 2016A Bonds. In addition, certain document amendments may be made without bondholder consent or notice. Any amendment could adversely affect the security for the Series 2016A Bonds.

Not All Affiliates are Restricted

The economic strength of the System could be affected by the economic strength of any of the affiliates (whether or not they are Obligated Affiliates or Restricted Affiliates) of BSW Holdings. The Master Indenture does not impose restrictions on BSW Holdings' affiliates that are not Obligated Affiliates or Restricted Affiliates. A substantial amount of the revenue-producing operations of the System is currently conducted by System affiliates that are not Obligated Affiliates. System affiliates may engage in a variety of not-for-profit and for-profit businesses. Should any of these business ventures have financial difficulties and BSW Holdings or any Obligated Affiliate be obligated or choose to contribute financial assistance, the financial condition of the Combined Group could be adversely impacted.

Other Factors Could Adversely Affect the System

Unemployment, decreased insurance coverage provided by employers or other adverse economic conditions could increase the proportion of patients who are uninsured or who are otherwise unable to pay fully for the cost of their care, and increased numbers of patients suffering from uninsured and extended illness could adversely affect the results of operation of the System.

As large employers, hospitals and health care providers may incur significant expenses to fund pension and benefit plans for employees and former employees, and to fund required workers' compensation benefits. Plans are often underfunded, or may become underfunded and funding obligations in some cases may be erratic or unanticipated and may require significant commitments of available cash needed for other purposes. See “**FINANCIAL INFORMATION – Retirement Plans**” in **APPENDIX A**.

Other potential risk factors may also affect the operation, and therefore revenues, of the System and its ability to maintain sufficient operating margins, including, among others: (i) the cost and availability of energy; (ii) the cost and availability of insurance, such as fire and general comprehensive liability and professional liability insurance, that hospitals of similar size and type generally carry; (iii) uninsured acts of God (including floods) or punitive damage judgments as to which insurance is not available; (iv) natural and man-made disasters, including

without limitation bioterrorism-induced epidemics and other terrorist activities; (v) imposition of wage and price controls for the health care industry; (vi) a decrease in population or change in demographics in the service areas of the System; (vii) an increase in the rate of inflation and difficulties in increasing service charges and other fees, while at the same time maintaining the amount and quality of health care services; and (viii) market risk adversely affecting investments of the System.

LITIGATION AND PROCEEDINGS

The Issuer

There is not now pending or, to the knowledge of the Issuer, threatened any litigation seeking to restrain or enjoin the issuance or delivery of the Series 2016A Bonds or questioning or affecting the validity of the Series 2016A Bonds or the proceedings or authority under which they are to be issued. Neither the creation, organization or existence of the Issuer, nor the title of any of the present members of the Board of Directors of the Issuer to their respective offices, is being contested. There is no litigation pending or, to the knowledge of the Issuer, threatened, which in any manner questions its right to enter into the Bond Indenture, or the Loan Agreement or to secure the Series 2016A Bonds in the manner provided in the Bond Indenture and the Act.

The System

As of the date of this Official Statement, there is no litigation or proceeding pending or, to the knowledge of BSW Holdings, threatened against it or any of the members of the System except (a) litigation, proceedings or claims involving professional liability claims or general liability claims in which the probable ultimate recoveries and the estimated costs and expenses of defense, in the opinion of counsel to BSW Holdings, will be entirely within applicable insurance policy limits (subject to applicable deductibles or self-insurance retentions) or not in excess of the total available reserves held under applicable self-insurance programs, and (b) litigation, proceedings or claims involving other types of claims which if adversely determined will not have a material adverse effect on the operations or financial condition of the System, taken as a whole.

LEGAL MATTERS

The issuance and delivery of the Series 2016A Bonds by the Issuer are subject to receipt of (i) the approving opinion of the Attorney General of the State of Texas and (ii) the opinion of Norton Rose Fulbright US LLP, Dallas, Texas, Bond Counsel, to the effect that the Series 2016A Bonds have been duly authorized, executed and delivered in accordance with Texas law and further to the effect that the Series 2016A Bonds constitute valid and legally binding limited obligations of the Issuer payable from the sources, and enforceable in accordance with their terms, except to the extent that the enforcement of the rights and remedies of the owners of the Series 2016A Bonds may be affected by bankruptcy, insolvency, reorganization, moratorium or other similar laws affecting creditors' rights or the exercise of judicial discretion in accordance with general principles of equity, and to the effect that the interest on the Series 2016A Bonds is excludable from gross income for federal income tax purposes, subject to the matters described in "**TAX EXEMPTION**" herein, including the alternative minimum tax consequences for corporations. The opinion of Bond Counsel will further state that no opinion is expressed or comment made with respect to the sufficiency of the security for or the marketability of the Series 2016A Bonds. Such opinion is expected to be in substantially the form attached hereto as **APPENDIX D**. Copies of such opinion will be available at the time of delivery of the Series 2016A Bonds. Certain legal matters will be passed upon for BSW Holdings and the other Obligated Affiliates by their counsel, Norton Rose Fulbright US LLP, Dallas, Texas; for the Issuer by its counsel, Brown Pruitt Wambsganss Ferrill & Dean, P.C., Fort Worth, Texas; and for the Bond Trustee and the Master Trustee by their counsel, Nathan Sommers Jacobs, a Professional Corporation, Houston, Texas. Certain legal matters will be passed upon for the Underwriters by their counsel, Bracewell LLP, Dallas, Texas.

The various legal opinions to be delivered concurrently with the delivery of the Series 2016A Bonds express the professional judgment of the attorneys rendering the opinions as to the legal issues explicitly addressed therein. In rendering a legal opinion, the attorney does not become an insurer or guarantor of the expression of

professional judgment, of the transaction opined upon, or of the future performance of the parties to the transaction, nor does the rendering of an opinion guarantee the outcome of any legal dispute that may arise out of the transaction.

TAX EXEMPTION

The delivery of the Series 2016A Bonds is subject to the receipt of an opinion of Norton Rose Fulbright US LLP, Bond Counsel ("**Bond Counsel**"), to the effect that, assuming compliance with the covenants described below, interest on the Series 2016A Bonds for federal income tax purposes, under existing statutes, regulations, published administrative rulings and court decisions, (i) will be excludable from the gross income, as defined in Section 61 of the Code, of the owners thereof pursuant to Section 103 of the Code and (ii) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations. The statutes, regulations, rulings, and court decisions on which such opinion will be based are subject to change.

Interest on the Series 2016A Bonds owned by a corporation (other than an S corporation, a qualified mutual fund, a real estate investment trust, a financial asset securitization investment trust ("**FASIT**"), or a real estate mortgage investment conduit) will be included in such corporation's adjusted current earnings for purposes of calculating the federal alternative minimum taxable income of such corporation. A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by Section 55 of the Code will be computed.

In rendering the foregoing opinions, Bond Counsel (i) will rely upon representations and certifications of the Issuer and BSW Holdings made in certificates dated the date of initial delivery of the Series 2016A Bonds pertaining to the use, expenditure, and investment of the proceeds of the Series 2016A Bonds and the qualification of BSW Holdings and other benefited affiliates as charitable exempt organizations, and (ii) will assume continuing compliance with the provisions of the Bond Indenture and the Loan Agreement by the Issuer and BSW Holdings subsequent to the issuance of the Series 2016A Bonds. The Bond Indenture and the Loan Agreement contain covenants by the Issuer and BSW Holdings with respect to, among other matters, the use of the proceeds of the Series 2016A Bonds and the facilities financed or refinanced therewith by persons other than state or local governmental units or organizations described in Section 501(c)(3) of the Code, the manner in which the proceeds of the Series 2016A Bonds are to be invested, the periodic calculation of and payment to the United States Treasury of arbitrage "profits" from the investment of the proceeds of the Series 2016A Bonds and the reporting of certain information to the United States Treasury. Failure by the Issuer or BSW Holdings to comply with any of these covenants could cause interest on the Series 2016A Bonds accruing from and after the date of issuance of the Series 2016A Bonds to be includable in the gross income of the owners thereof.

Bond Counsel's opinion is not a guarantee of a result, but represents its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the Issuer and BSW Holdings described above. No ruling has been sought from the IRS with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel's opinion is not binding on the IRS. The IRS has an ongoing program of auditing the tax-exempt status of the interest on tax-exempt obligations. If an audit of the Series 2016A Bonds is commenced, under current procedures the IRS is likely to treat the Issuer as the "taxpayer," and the owners of the Series 2016A Bonds would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Series 2016A Bonds, the Issuer may have different or conflicting interests from the owners of the Series 2016A Bonds. Public awareness of any future audit of the Series 2016A Bonds could adversely affect the value and liquidity of the Series 2016A Bonds during the pendency of the audit, regardless of its ultimate outcome.

Except as described above, Bond Counsel will express no other opinion with respect to any other federal, state, or local tax consequences under present law, or proposed legislation, resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Series 2016A Bonds. Prospective purchasers of the Series 2016A Bonds should be aware that the ownership of tax-exempt obligations such as the Series 2016A Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance and property and casualty insurance companies, certain foreign corporations doing business in the United States of America, S corporations with subchapter C earnings and profits, owners of an interest in a FASIT, individual recipients of Social Security or

Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

Existing law may change to reduce or eliminate the benefit to bondholders of the exclusion of interest on the Series 2016A Bonds from gross income for federal income tax purposes. Any proposed legislation or administrative action, whether or not taken, could also affect the value and marketability of the Series 2016A Bonds. Prospective purchasers of the Series 2016A Bonds should consult with their own tax advisors with respect to any proposed or future changes in tax law.

A copy of the form of opinion of Bond Counsel is included in this Official Statement in **APPENDIX D**.

TAX ACCOUNTING TREATMENT OF DISCOUNT AND PREMIUM ON THE SERIES 2016A BONDS

The initial public offering price of certain Series 2016A Bonds (the “*Discount Bonds*”) may be less than the amount payable on such Series 2016A Bonds at maturity. An amount equal to the difference between the initial public offering price of a Discount Bond (assuming that a substantial amount of the Discount Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Bond. A portion of such original issue discount allocable to the holding period of such Discount Bond by the initial purchaser will, upon the disposition of such Discount Bond (including by reason of its payment at maturity), be treated as interest excludable from gross income, rather than as taxable gain, for federal income tax purposes, on the same terms and conditions as those for other interest on the Series 2016A Bonds described above under “**TAX EXEMPTION.**” Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Bond, taking into account the semiannual compounding of accrued interest, at the yield to maturity on such Discount Bond and generally will be allocated to an initial purchaser in a different amount from the amount of the payment denominated as interest actually received by the initial purchaser during the tax year.

However, such interest may be required to be taken into account in determining the alternative minimum taxable income of a corporation, for purposes of calculating a corporation's alternative minimum tax imposed by Section 55 of the Code, and the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, S corporations with subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a FASIT, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Moreover, in the event of the redemption, sale or other taxable disposition of a Discount Bond by the initial owner prior to maturity, the amount realized by such owner in excess of the basis of such Discount Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Bond was held) is includable in gross income.

Owners of Discount Bonds should consult with their own tax advisors with respect to the determination of accrued original issue discount on Discount Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Discount Bonds. It is possible that, under applicable provisions governing determination of state and local income taxes, accrued interest on Discount Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment.

The initial public offering price of certain Series 2016A Bonds (the “*Premium Bonds*”) may be greater than the amount payable on such Series 2016A Bonds at maturity. An amount equal to the difference between the initial public offering price of a Premium Bond (assuming that a substantial amount of the Premium Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes premium to the initial purchaser of such Premium Bonds. The basis for federal income tax purposes of a Premium Bond in the hands of such initial purchaser must be reduced each year by the amortizable bond premium, although no federal income tax

deduction is allowed as a result of such reduction in basis for amortizable bond premium. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon a sale or other taxable disposition of a Premium Bond. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser's yield to maturity.

Purchasers of the Premium Bonds should consult with their own tax advisors with respect to the determination of amortizable bond premium on Premium Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Premium Bonds.

FINANCIAL STATEMENTS

The combined financial statements of the System for the year ended June 30, 2015 and the nine months ended June 30, 2014, included in **APPENDIX B-1**, have been audited by PricewaterhouseCoopers LLP, independent accountants, as stated in their report appearing in **APPENDIX B-1**.

The unaudited interim combined financial statements of the System for the six months ended December 31, 2015 and 2014, are included in **APPENDIX B-2**. Such unaudited financial statements have been prepared by the System and are unaudited.

UNDERWRITING

Citigroup Global Markets Inc., J.P. Morgan Securities LLC, Estrada Hinojosa & Company, Inc., and Siebert Brandford Shank & Co., L.L.C. (collectively, the "*Underwriters*") have agreed, jointly and severally, to purchase the Series 2016A Bonds at a discount of \$1,790,486 from the aggregate prices shown on the cover page subject to certain conditions pursuant to a contract of purchase (the "*Contract of Purchase*") between the Issuer and the Underwriters. The Contract of Purchase provides that the Underwriters will purchase all of the Series 2016A Bonds if any are purchased. The Obligated Affiliates have agreed, jointly and severally, to indemnify the Underwriters and the Issuer against certain liabilities, including certain liabilities arising under federal and state securities laws.

The Underwriters may offer and sell Series 2016A Bonds to certain dealers (including dealers depositing Series 2016A Bonds into unit investment trusts) and others at prices lower than the public offering prices stated on the cover page hereof. The initial offering prices may be changed from time to time by the Underwriters.

The Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage services. Certain of the Underwriters and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for BSW Holdings and its affiliates for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Underwriters and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities, which may include credit default swaps) and financial instruments (including bank loans) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve securities and instruments for BSW Holdings and its affiliates.

The Underwriters and their respective affiliates may also communicate independent investment recommendations, market color or trading ideas and/or publish or express independent research views in respect of long and/or short positions in such assets, securities and instruments.

Citigroup Global Markets Inc., an underwriter of the Series 2016A Bonds, has entered into a retail distribution agreement with each of TMC Bonds L.L.C. ("*TMC*") and UBS Financial Services Inc. ("*UBSFS*"). Under these distribution agreements, Citigroup Global Markets Inc. may distribute municipal securities to retail

investors through the financial advisor network of UBSFS and the electronic primary offering platform of TMC. As part of this arrangement, Citigroup Global Markets Inc. may compensate TMC (and TMC may compensate its electronic platform member firms) and UBSFS for their selling efforts with respect to the Series 2016A Bonds.

J.P. Morgan Securities LLC (“*JPMS*”), one of the Underwriters of the Series 2016A Bonds, has entered into negotiated dealer agreements (each, a “*Dealer Agreement*”) with each of Charles Schwab & Co., Inc. (“*CS&Co.*”) and LPL Financial LLC (“*LPL*”) for the retail distribution of certain securities offerings at the original issue prices. Pursuant to each Dealer Agreement, each of CS&Co. and LPL may purchase Series 2016A Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any Series 2016A Bonds that such firm sells.

Siebert Brandford Shank & Co., L.L.C. (“*SBS*”) has entered into an agreement with Muriel Siebert & Co. for the retail distribution of certain securities offerings, at the original issue prices. Pursuant to said agreement, if applicable to the Series 2016A Bonds, Muriel Siebert & Co. will purchase Series 2016A Bonds at the original issue price less the selling concession with respect to any Series 2016A Bonds that such Muriel Siebert & Co. sells. SBS will share a portion of its underwriting compensation with Muriel Siebert & Co.

FINANCIAL ADVISOR

BSW Holdings has retained Kaufman, Hall & Associates, LLC (“*Kaufman Hall*”), Skokie, Illinois, as financial advisor in connection with the issuance of the Series 2016A Bonds. Although Kaufman Hall has assisted in the preparation of this Official Statement, Kaufman Hall was not and is not obligated to undertake, and has not undertaken to make, an independent verification and assumes no responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Causey Demgen & Moore, P.C. (the “*Verification Agent*”), will independently verify, and issue a report thereon, the arithmetical accuracy of the computations included in schedules provided to them by the Underwriters indicating (a) the sufficiency of the anticipated receipts from the securities deposited under to the escrow fund, together with an initial cash deposit, to pay the principal or redemption prices of and interest on the Series 2010 Bonds on and prior to their maturity or redemption dates, as applicable, and (b) yields on the Series 2016A Bonds and the amounts deposited to the escrow fund. Such verification will be based solely on assumptions and information supplied by the Underwriters. Furthermore, the Verification Agent will have restricted its procedures to verifying the arithmetical accuracy of such computations and will not have made any study or evaluation of the assumptions and information on which the computations were based and, accordingly, will not express an opinion on such assumptions and information, the reasonableness of such assumptions, or the achievability of future events. Such verification report will be relied upon by Bond Counsel in rendering its opinions with respect to the defeasance of the Series 2010 Bonds and the exclusion from gross income of interest on the Series 2016A Bonds for federal income tax purposes.

RATINGS

Moody’s Investors Service, Inc. (“*Moody’s*”) has assigned a rating of “Aa3” to the Series 2016A Bonds and Standard & Poor’s Ratings Services, a Standard & Poor’s Financial Services LLC business (“*S&P*”), has assigned a rating of “AA-” to the Series 2016A Bonds. The ratings and an explanation of their significance may be obtained from the rating agencies furnishing such ratings. Such ratings reflect only the respective views of the rating agencies and are not a recommendation to buy, sell or hold the Series 2016A Bonds.

BSW Holdings furnished such rating agencies with certain information and materials relating to the Series 2016A Bonds and the members of the System that have not been included in this Official Statement. Generally, rating agencies base their ratings on the information and materials so furnished and on investigations, studies, and assumptions by the rating agencies. There is no assurance that a particular rating will be maintained for any given period of time or that it will not be lowered or withdrawn entirely if, in the judgment of the agency originally establishing the rating, circumstances so warrant. Except as described under the caption “**CONTINUING**

DISCLOSURE OF INFORMATION” herein, none of the Issuer, the Underwriters, or the Obligated Affiliates has undertaken any responsibility to bring to the attention of the registered owners of the Series 2016A Bonds any proposed revision or withdrawal of the ratings of the Series 2016A Bonds or to oppose any such proposed revision or withdrawal. Any such change in or withdrawal of such rating could have an adverse effect on the market price or marketability of the Series 2016A Bonds.

CONTINUING DISCLOSURE OF INFORMATION

Continuing Disclosure

In accordance with the continuing disclosure provisions of Rule 15c2-12 of the United States Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time (the “**Rule**”), BSW Holdings has entered into a Continuing Disclosure Agreement (the “**Disclosure Agreement**”), for the benefit of the holders of the Series 2016A Bonds, with Digital Assurance Certification, L.L.C. (“**DAC**”), under which BSW Holdings has designated DAC as Disclosure Dissemination Agent. In the Disclosure Agreement, BSW Holdings will agree for the benefit of the holders of the Series 2016A Bonds that it will provide certain updated financial information and operating data about itself annually, within 180 days of the end of each fiscal year, and timely notice of specified material events, to DAC for dissemination to the Municipal Securities Rulemaking Board (the “**MSRB**”). The information will be available free of charge from the MSRB via the Electronic Municipal Market Access system (“**EMMA**”) at emma.msrb.org.

The form of the Disclosure Agreement is attached hereto as **APPENDIX E**.

Quarterly Reports

As of the date of this Official Statement, BSW Holdings also intends to provide to the Disclosure Dissemination Agent, within 60 days after the end of each of the first three quarterly fiscal periods of each fiscal year of BSW Holdings, unaudited financial statements of BSW Holdings and its affiliates and certain operating data, as of the end of each such quarterly period, shown in each case in comparative form with the same period of the preceding fiscal year, all in reasonable detail (the “**Quarterly Reports**”). BSW Holdings is not obligated in any way to provide such Quarterly Reports and may discontinue providing such Quarterly Reports at any time.

Availability of Information from MSRB

The obligation of BSW Holdings is to provide the foregoing information only to the Disclosure Dissemination Agent to be filed with the MSRB. BSW Holdings has not undertaken any other continuing disclosure obligation. All such information filed with the MSRB will be available to the public through the MSRB’s website located at emma.msrb.org.

Compliance with Prior Undertakings

BSW Holdings has not previously entered into a continuing disclosure agreement in accordance with the Rule. Prior to the combination of BHCS and S&W, however, each entity entered into continuing disclosure agreements relating to their respective tax-exempt bonds. Each of BHCS and S&W timely filed annual reports as required by their respective continuing disclosure agreements. Such filings, however, inadvertently omitted certain information, including relating to Scott & White Clinic visits, market share, admissions and debt service coverage and notice of the failure to file such omitted information, that was required by such continuing disclosure agreements to be filed. BSW Holdings, BHCS and S&W have subsequently filed information intended to provide certain of the omitted information.

MISCELLANEOUS

The references herein and in **APPENDIX C** to the Act, the Master Indenture, the Bond Indenture and the Loan Agreement are brief outlines of certain provisions thereof. Such outlines do not purport to be complete, and for full and complete statements of the provisions thereof, reference is made to the Act, the Master Indenture, the

Bond Indenture and the Loan Agreement. Copies of the drafts of the Master Indenture, the Bond Indenture and the Loan Agreement are on file at the offices of the Underwriters and following delivery of the Series 2016A Bonds copies of such documents will be on file at the office of the Bond Trustee.

Neither any advertisement of the Series 2016A Bonds nor this Official Statement is to be construed as constituting an agreement with the purchasers of the Series 2016A Bonds. So far as any statements are made in the Official Statement involving estimates, projections or matters of opinion, whether or not expressly so stated, they are intended merely as such and not as representations of fact.

CUSIP identification numbers will be printed on the Series 2016A Bonds, but no error in the printing of such numbers shall constitute cause for a failure or refusal by the purchaser thereof to accept delivery of and pay for any Series 2016A Bonds.

The Appendices hereto are integral parts of this Official Statement and should be read together with all of the foregoing statements.

BSW Holdings has reviewed the information contained herein which relates to BSW Holdings and the members of the System, their property and operations, and has authorized all such information for use in this Official Statement and has approved this Official Statement.

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APPENDIX A

APPENDIX A

**Information Concerning
BAYLOR SCOTT & WHITE HOLDINGS
and Affiliates**

The information contained herein as APPENDIX A to this Official Statement has been obtained from Baylor Scott & White Holdings and other sources determined to be reliable.

Capitalized terms used, but not defined, in this APPENDIX A are defined in the forepart of this Official Statement or in APPENDIX C to this Official Statement.

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BAYLOR SCOTT & WHITE HEALTH OVERVIEW

INTRODUCTION

Baylor Scott & White Health is the largest not-for-profit health care system in the State of Texas and one of the largest in the United States as measured by total operating revenue of \$7.5 billion and \$4.0 billion for the fiscal year ended June 30, 2015 and the six months ended December 31, 2015, respectively, and total assets of \$9.7 billion and \$9.9 billion at June 30, 2015 and December 31, 2015, respectively. Serving a population larger than the state of Georgia across North and Central Texas, Baylor Scott & White Health has the vision and resources to provide its patients continued quality care while creating a model system for a dramatically changing health care environment. The Baylor Scott & White Health system includes 47 hospitals, more than 900 access points, and over 6,600 physicians, plus a state certified Health Maintenance Organization, the Scott and White Health Plan (the “*Health Plan*”), and Baylor Quality Health Care Alliance LLC – a high performing network of clinical providers and facilities focused on improving quality, managing the health of patient populations, and reducing the overall cost of care – a Texas limited liability company doing business as Baylor Scott & White Quality Alliance (“*BSWQA*”). The Baylor Scott & White Health system employs over 43,500 employees (including employees of controlled joint ventured facilities as of January 1, 2016).

Baylor Scott & White Holdings (“*BSW Holdings*”) is a Texas nonprofit corporation that was formed in June 2013, began operations October 1, 2013 and is exempt from federal income taxation under Section 501(a) of the Internal Revenue Code of 1986, as amended (the “*Code*”), by virtue of being an entity described in Section 501(c)(3) of the Code. BSW Holdings and its controlled affiliates (collectively, the “*System*”) was created from the combination of two Texas health care systems, Baylor Health Care System (“*BHCS*”) and its affiliates (the “*North Texas Division*”) and Scott & White Healthcare (“*S&W*”) and its affiliates (the “*Central Texas Division*”). BSW Holdings and Baylor Scott & White Health, a Texas nonprofit corporation (“*BSW Health*”), were created by BHCS and S&W in connection with their combination. BSW Holdings is the sole member of BHCS and S&W and has control and substantial reserved powers over all BHCS and S&W material affiliates.

As more fully described herein, the System includes a robust spectrum of owned, operated, ventured and affiliated hospitals, satellite outpatient clinics, free standing ambulatory surgery centers, free standing emergency medical centers, free standing imaging centers, numerous retail pharmacies, and geographically dispersed physicians clinics in the North Texas Division and Central Texas Division. The System is not currently affiliated with Baylor University.

MISSION, VISION AND VALUES

| | |
|--------------------------|--|
| Our Mission | <i>Baylor Scott & White Health exists to serve all people by providing personalized health and wellness through exemplary care, education and research as a Christian ministry of healing.</i> |
| Our Vision | <i>To be the most trusted name in giving and receiving safe, quality, compassionate health care.</i> |
| Our Values | <ul style="list-style-type: none">• Integrity• Servanthood• Teamwork• Excellence• Innovation• Stewardship |
| The Four Non-Negotiables | <ol style="list-style-type: none">1. <i>Putting the patient first in everything we do</i>2. <i>Staying true to our mission</i>3. <i>Living our values</i>4. <i>Doing the right thing for the right reason</i> |

HISTORY

Baylor Health Care System began with the establishment of the Texas Baptist Memorial Sanitarium in North Texas in 1903. Dr. Charles Rosser aimed to address a need for qualified and well-educated physicians by establishing a medical school. Joined by Rev. George W. Truett and Colonel C.C. Slaughter, the trio chartered the Sanitarium as “a great humanitarian hospital” for the growing city of Dallas. In 1921, the Sanitarium became Baylor Hospital to reflect its close relationship with Baylor University. In 1959, Baylor University Hospital was renamed Baylor University Medical Center at Dallas to reflect the multiple hospitals and services on the Dallas campus.

In Central Texas, two surgeons, Dr. Arthur C. Scott and Dr. Raleigh R. White, entered a physician partnership in 1897, serving the town of Temple as surgeons for the Santa Fe Railroad Hospital. In 1904, Dr. Scott and Dr. White decided to open their own hospital, the Temple Sanitarium, and applied for a corporate charter “for the study, prevention, relief, remedy and care of any and all human disorders and diseases.” This hospital grew and was eventually renamed Scott & White Memorial Hospital. This one hospital came together with the Scott & White Clinic in 1949.

Before the integration, BHCS and S&W each grew into systems respected nationally for quality patient care, medical research and education.

OBLIGATED GROUP

BSW Holdings and certain of its affiliates issue and secure debt (“*Master Debt*”) under a Master Indenture of Trust and Security Agreement, dated as of February 1, 2014, as supplemented and amended (the “*Master Indenture*”), among BSW Holdings, the affiliates from time to time obligated thereunder (the “*Obligated Affiliates*”), and The Bank of New York Mellon Trust Company, National Association, as trustee. The following entities are currently Obligated Affiliates:

- BSW Holdings
- BHCS
- S&W
- Baylor University Medical Center, a Texas nonprofit corporation (“*BUMC*”)
- Baylor All Saints Medical Center, a Texas nonprofit corporation (“*All Saints*”), doing business as Baylor Scott & White All Saints Medical Center – Fort Worth
- Baylor Regional Medical Center at Grapevine, a Texas nonprofit corporation (“*Grapevine*”), doing business as Baylor Scott & White Medical Center – Grapevine
- Baylor Medical Center at Waxahachie, a Texas nonprofit corporation (“*Waxahachie*”), doing business as Baylor Scott & White Medical Center – Waxahachie
- Baylor Regional Medical Center at Plano, a Texas nonprofit corporation (“*Plano*”), doing business as Baylor Scott & White Medical Center – Plano
- Scott & White Memorial Hospital, a Texas nonprofit corporation (“*Memorial Hospital*”)
- Scott & White Clinic, a Texas nonprofit corporation (“*S&W Clinic*”)
- Scott & White Hospital – Round Rock, a Texas nonprofit corporation (“*Round Rock*”), doing business as Baylor Scott & White Medical Center – Round Rock
- Scott & White Continuing Care Hospital, a Texas nonprofit corporation (the “*Continuing Care Hospital*”), doing business as Baylor Scott & White Continuing Care Hospital
- Hillcrest Baptist Medical Center, a Texas nonprofit corporation (“*Hillcrest Medical Center*”), doing business as Baylor Scott & White Medical Center – Hillcrest

It is anticipated that effective on the closing date of the Series 2016A Bonds, the following three entities will be added as Obligated Affiliates under the Master Indenture: (1) Baylor Medical Centers at Garland and McKinney, a Texas nonprofit corporation (“*McKinney*”), doing business as Baylor Scott & White Medical Center – McKinney,¹ (2) Scott & White Hospital – College Station, a Texas nonprofit corporation (“*College Station*”), and (3) BSW Health. BSW Holdings is currently the Combined Group Representative under the Master Indenture. There are currently no Designated Affiliates under the Master Indenture.

No System entities other than the Obligated Affiliates, including any affiliates or subsidiaries of an Obligated Affiliate, have any liability with respect to the payment of the principal of, premium, if any, or interest on the Master Debt. The obligations of the Obligated Affiliates to pay the Master Debt are subject to limitations described under “BONDHOLDERS’ RISKS – The Contractual Undertakings of the Obligated Affiliates May Not be Fully Enforceable” in the Official Statement.

For the fiscal year ended June 30, 2015, the Obligated Affiliates accounted for 53.3% of the consolidated total operating revenue and 53.3% of the consolidated total operating expenses of the System. At June 30, 2015, the Obligated Affiliates accounted for 81.2% of the consolidated total assets of the System. On a proforma basis for the fiscal year ended June 30, 2015, giving effect to the addition of McKinney, College

¹ Effective January 1, 2016 the operations and certain assets for Baylor Scott & White Medical Center – Garland were sold by McKinney to the new joint venture with Tenet: BT-Garland JV. The percentages above include operating revenue, operating expenses, and assets attributable to Baylor Scott & White Medical Center – Garland as Baylor Scott & White Medical Center – Garland was part of the legal entity of McKinney as of June 30, 2015.

Station and BSW Health as Obligated Affiliates, the proforma Obligated Affiliates accounted for 61.6% of the consolidated total operating revenue and 62.2% of the consolidated total operating expenses of the System. At June 30, 2015, the proforma Obligated Affiliates accounted for 83.4% of the consolidated total assets of the System. Compliance with the covenants in the Master Indenture is currently calculated based on the consolidated financial statements of the System, which include the financial results, assets and liabilities of System entities that are not Obligated Affiliates and of certain joint ventures and partnerships that are not wholly-owned by System entities.

AWARDS AND DISTINCTIONS

| THE SYSTEM | |
|---|--|
| The System is recognized as one of the leading health care delivery systems across the United States, having received the following recognitions, among others: | |
| <i>U.S. News & World Report</i> | According to U.S. News & World Report’s “Best Hospitals” and “Best Hospitals for Common Care” 2015-2016 ratings, 11 Baylor Scott & White Health hospitals received recognition, more than any other health care system in Texas. |
|  | Six hospitals with Magnet® designation for nursing excellence by the American Nurses Credentialing Center (achieved by less than 7% of hospitals nationwide). |
|  | Sixty three HealthTexas Provider Network (“HealthTexas”) and fifty two S&W clinics have received the National Committee for Quality Assurance (“NCQA”) Patient-Centered Medical Home Recognition for using evidence-based, patient-centered processes that focus on highly coordinated care and long-term, participative relationships. |
| <i>Healthiest Employers</i> | Ranked #10 in the top 100 Healthiest Employers in America. |
| BAYLOR UNIVERSITY MEDICAL CENTER | |
| <i>U.S. News & World Report</i> | Baylor University Medical Center is ranked as the No. 1 hospital in the Dallas Metro Area, as well as No. 3 in Texas, and was nationally recognized for the 23rd consecutive year. |
|  | Named as one of the top 50 hospitals nationally in three specialties: Gastroenterology & GI Surgery, Diabetes & Endocrinology, Neurology & Neurosurgery; ranked National High Performer in eight specialties: Cancer, Ear, Nose & Throat, Geriatrics, Gynecology, Nephrology, Orthopedics, Pulmonology and Urology; and recognized for clinical excellence in treating Chronic Obstructive Pulmonary Disease and Congestive Heart Failure. |
|  | Earned third consecutive Magnet® designation. Fewer than 2% of the nation’s hospitals have achieved this designation three consecutive times. |

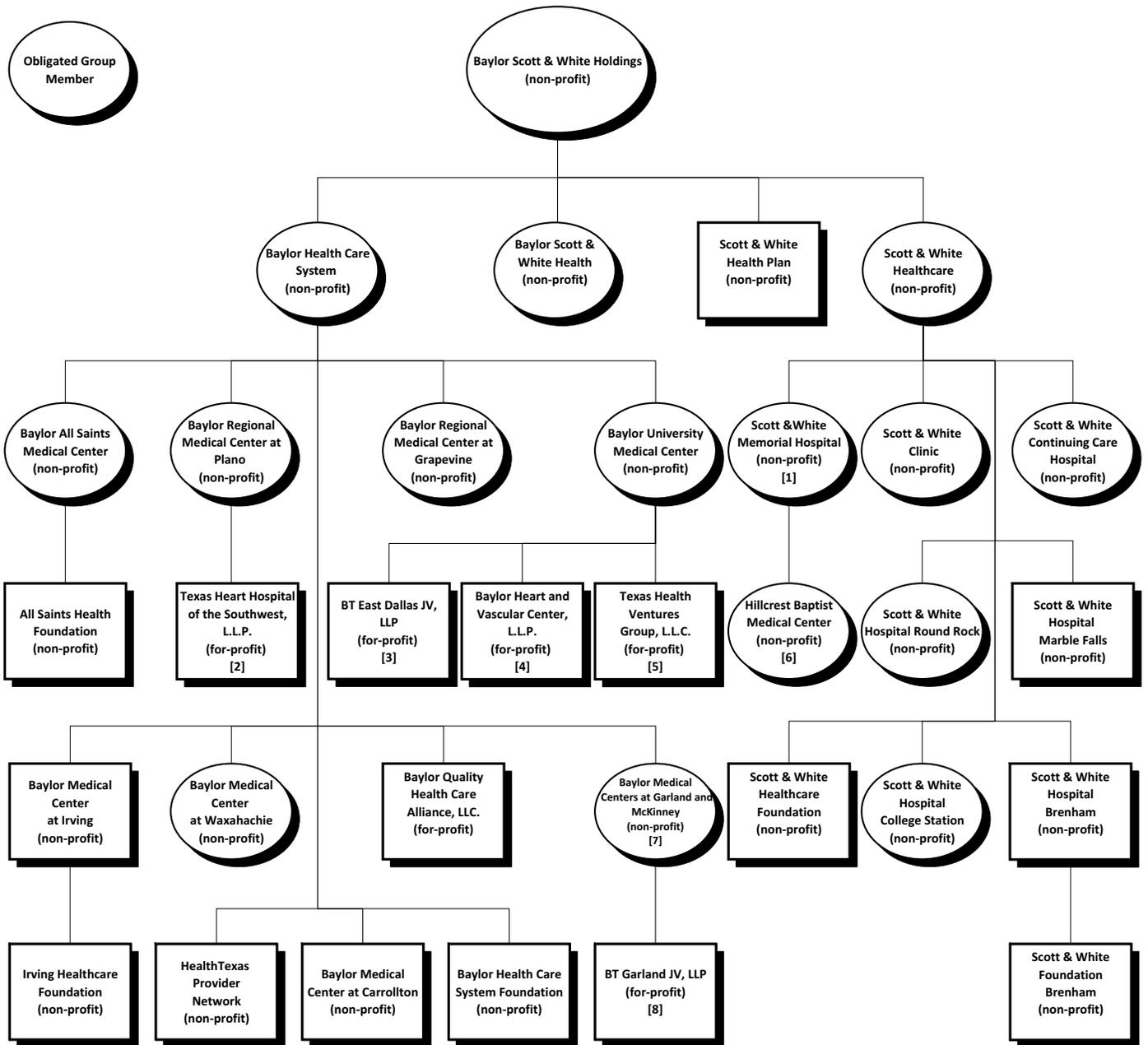
| | |
|---|---|
|  | <p>Reaccredited with a Gold Seal of Approval™ by The Joint Commission for the Ventricular Assist Device Program, the nation's first such accredited program.</p> |
| <p>National Research Corporation</p> | <p>For the 19th consecutive year, awarded the Consumer Choice Award for Best Overall Quality, Best Doctor, Best Nurses and Best Image/Reputation among hospitals in North Texas.</p> |
| <p>SCOTT & WHITE MEMORIAL HOSPITAL</p> | |
| <p><i>U.S. News & World Report</i></p> | <p>“Best Hospitals for Common Care” for excellence in treating Chronic Obstructive Pulmonary Disease.</p> |
| <p><i>Becker's Hospital Review</i></p> | <p>100 Hospitals and Health Systems with Great Oncology Programs in U.S. for Glenda Tanner Vasicek Cancer Center.</p> |
| <p>American Heart Association/American Stroke Association</p> | <p>Get with the Guidelines® Stroke Honor Roll – Elite Quality Achievement Award.</p> |
|  | <p>The Gold Seal of Approval; Accredited Programs in Hospital, Nursing Care Center, Home Care; Advanced Certification in Stroke (Primary Stroke Center) and Ventricular Assist Device.</p> |
| <p>BAYLOR SCOTT & WHITE QUALITY ALLIANCE</p> | |
|  | <p>In 2015, BSWQA was awarded a three-year accreditation as a Level 2 accountable care organization, the first to be awarded the recognition in North Texas and the second in the state.</p> |
| <p><i>Becker's Hospital Review</i></p> | <p>Named to Becker's Top 100 ACOs to Know in 2013.</p> |
| <p>SCOTT & WHITE HEALTH PLAN</p> | |
|  | <p>For the third year in a row, the Health Plan is rated the #1 plan in Texas for both commercial and Medicare insurance by NCQA, and is rated 4 stars by the Centers for Medicare and Medicaid Services.</p> |

CORPORATE ORGANIZATION

Each of the Obligated Affiliates, other than BSW Holdings, is a Texas nonprofit membership corporation. BSW Holdings has reserved rights and powers to manage the business and affairs of each Obligated Affiliate, except for those matters that the bylaws of an Obligated Affiliate expressly provide shall be managed or performed by its board of directors or trustees. In the case of Hillcrest Medical Center, its bylaws have specific reserved powers that are exercised jointly by Memorial Hospital and Hillcrest Health System, Inc., the holder of a 20% membership interest in Hillcrest Medical Center. The bylaws of each Obligated Affiliate in effect on the date of this Official Statement enumerate certain specific powers, duties and responsibilities for its board of directors or trustees, including those required by state or federal law or regulation or the accreditation standards of The Joint Commission to be exercised by its board of directors or trustees. The board of trustees of BSW Holdings elects and may remove all of the members of the governing boards of BUMC, Memorial Hospital and, other than Hillcrest Medical Center, the other acute care community hospital members of the System. Hillcrest Medical Center's governing body is comprised of 12 members, six of which are elected and may be removed by Memorial Hospital.

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**Baylor Scott & White Holdings
(Material Operating Affiliates)**



(Unless otherwise noted all entities' Board members are appointed by BSW Holdings Board.)

¹ Includes McClane Children's Hospital - Scott & White which is operated under Scott & White Memorial Hospital's license.

² Baylor Regional Medical Center at Plano owns approximately 50.1%. BSW Holdings appoints majority of Board.

³ Baylor University Medical Center (BUMC) owns approximately 75%. BSW Holdings appoints majority of Board.

⁴ BUMC owns approximately 51%. BSW Holdings appoints majority of Board.

⁵ BUMC owns 50.1%. BSW Holdings appoints majority of Board.

⁶ Scott & White Memorial Hospital owns 80%. BSW Holdings appoints 6 of 12 board members.

⁷ Only includes Baylor Scott & White Medical Center - McKinney.

⁸ Only includes Baylor Scott & White Medical Center - Garland.

Material Operating Affiliates includes members of the obligated group, affiliates with greater than 5% of the system total operating revenue (based on the fiscal year ended June 30, 2015) and other affiliates deemed important by management.

GOVERNANCE AND MANAGEMENT

GOVERNANCE

As a non-member, nonprofit corporation, BSW Holdings is governed by a self-perpetuating board of trustees (the “Board”) consisting of 16 voting members. A majority of the members of the Board must be Baptist, and at least four members of the Board must be licensed Texas physicians. The chief executive officer of BSW Holdings is also an *ex officio* member of the Board, without a vote. Other members of the Board are elected for a term of three years, with the initial member terms staggered as set forth below, and each member of the Board is eligible to serve three consecutive terms. The Board has five regular meetings throughout the year and also acts by and through several committees, including its executive, finance and investment, audit and compliance, compensation and governance, and quality committees.

BOARD MEMBERS

| Voting Member | Title | Occupation | Current Term Expires July 1, |
|--|-----------------------|--|------------------------------|
| Joel T. Allison, <i>ex officio</i> ⁽¹⁾⁽⁶⁾ | Member | CEO, BSW Holdings | N/A |
| Alejandro C. Arroliga, M.D. ⁽²⁾ | Member | Chair, Scott & White Clinic Board of Directors, Professor of Medicine | 2016 |
| Albert C. Black, Jr. ⁽²⁾ | Member | President and CEO, On-Target Supplies & Logistics, Ltd. | 2017 |
| E.R. Brooks ⁽¹⁾⁽⁴⁾ | Member | Retired President and CEO, Central and Southwest Corporation | 2017 |
| Ronald L. Carter ⁽³⁾ | Member | Investor | 2017 |
| Ed Kinkeade ⁽⁴⁾ | Member | Federal Judge, U.S. District Court, Northern District of Texas | 2018 |
| Paul Madeley, M.D. ⁽²⁾ | Member | Physician, HealthTexas Provider Network | 2016 |
| Jack Martin ⁽²⁾ | Member | Global Chairman & CEO, Hill+Knowlton Strategies | 2017 |
| Ross McKnight ⁽¹⁾⁽²⁾ | Vice Chair | Rancher and Chairman of the Board, Olney Bancshares of Texas, Inc. | 2018 |
| Drayton McLane, Jr. ⁽¹⁾⁽²⁾ | Member and Past Chair | Chairman, McLane Group, Inc. | 2018 |
| Lyndon L. Olson, Jr. ⁽⁴⁾ | Member | Former Senior Advisor to Chairman – Citigroup. Former Ambassador to Sweden | 2018 |
| Anita Perry ⁽⁵⁾ | Member | Former First Lady, State of Texas | 2017 |
| William Rayburn, M.D. ⁽⁵⁾ | Member | Physician, Obstetrics/Gynecology | 2016 |
| Kenneth W. Starr ⁽³⁾ | Member | President, Baylor University | 2017 |
| Jim L. Turner ⁽¹⁾ | Chair | Principal, JLT Beverages, L.P. | 2018 |

| Voting Member | Title | Occupation | Current Term Expires July 1, |
|-----------------------------------|--------|---|------------------------------|
| David B. Walls ⁽³⁾ | Member | President and CEO, Austin Industries, Inc. | 2018 |
| David Winter, M.D. ⁽⁵⁾ | Member | Physician and Chair, HealthTexas Provider Network | 2016 |

- (1) Member of Executive Committee.
- (2) Member of Finance and Investment Committee.
- (3) Member of Audit and Compliance Committee.
- (4) Member of Compensation and Governance Committee.
- (5) Member of Quality Committee.
- (6) The Chief Executive Officer serves as a member while holding such office.

STANDING BOARD COMMITTEES

Executive Committee The Executive Committee provides a mechanism for Board leaders to engage, within the limits set by Board policy and the BSW Holdings’ bylaws, in decision making, oversight, and communication on important organizational matters. The Executive Committee may make decisions on issues as directed by the full Board that must be made before the next meeting of the full Board. The Executive Committee does not have final decision making authority unless so directed by the full Board.

Finance and Investment Committee The Finance and Investment Committee assists the Board in its oversight responsibilities relating to financial management and investment activities of the System by recommending financial policies, targets and budgets that support the mission, vision, values, and strategic goals of the System. The Committee reviews financial and investment performance against goals, and also reviews and recommends financial policies, operating and capital budgets, and major transactions. Unless specifically delegated from the Board, all Finance and Investment Committee actions are subject to approval by the Board.

Audit and Compliance Committee The Audit and Compliance Committee assists the Board in fulfilling its oversight responsibilities by monitoring (1) the integrity of the financial statements of the System; (2) the compliance by the System with applicable laws, regulatory requirements, industry guidelines, and policies; (3) the independence and performance of the System’s internal and external auditors; and (4) systems of internal accounting and financial controls.

Compensation and Governance Committee The Compensation and Governance Committee assists the Board in its responsibilities by recommending policies and processes to the Board for regular and orderly review of the performance, compensation, succession and development of the executives of BSW Holdings and its controlled affiliates. The committee is also responsible for conducting the Chief Executive Officer’s evaluation process, ensuring that executive compensation meets IRS requirements, reviewing and recommending to the Board an incentive compensation program that allows for the recruiting and retention of superior talent and provides incentives to successfully accomplish the System’s goals, and nominating members for all boards in the System.

Quality Committee The Quality Committee assists the Board in overseeing System-wide practices and performance relating to quality and service excellence, including patient safety, clinical effectiveness, clinical efficiency, equity and patient centeredness. The committee also sets expectations for management in the areas of national recognition of quality, cost of care, value based purchasing, standardization of best practices, and accreditation. The committee is responsible for reviewing and recommending to the Board

System-wide quality improvement plans and patient safety plans and reviewing and reporting on quality and patient care issues that have significant potential impact on the System.

MANAGEMENT BIOGRAPHIES

JOEL T. ALLISON (68), *President and Chief Executive Officer*. Mr. Allison joined BHCS in 1993, and served as Senior Executive Vice President and Chief Operating Officer of BHCS before being promoted to President and Chief Executive Officer in 2000. On October 1, 2013, he was named Chief Executive Officer of BSW Holdings. Mr. Allison's career includes more than four decades in health care management; prior to joining BHCS, he served as Chief Executive Officer of three other health care organizations. He graduated in 1970 from Baylor University, Waco, Texas with a BA, received his MS in Health Administration from Trinity University, San Antonio, Texas in 1973, and is a 2004 graduate of the Advanced Management Program at Harvard Business School. Mr. Allison is a Fellow of the American College of Healthcare Executives. He serves on the Healthcare Leadership Council and the United Surgical Partners International board and is involved in many other state and local organizations, including the Texas Business Leadership Council, Texas Association of Voluntary Hospitals, Texas Care Alliance, Baylor University Board of Regents, Dallas Citizens Council and the Denison Forum on Truth and Culture.

On February 29, 2016, Mr. Allison and the Board announced plans for Mr. Allison to transition from his role as President and Chief Executive Officer to senior advisor to the chair of the Board. The transition will occur February 1, 2017. The Board will conduct a national search for a successor to Mr. Allison.

JOHN MCWHORTER (57), *Executive Vice President and Chief Operating Officer*. Dr. McWhorter has over 20 years' experience with BSW Holdings and its predecessor organizations. In his current role, he is responsible for the System's hospitals including both wholly owned and partnerships, clinics and patient care sites. In his prior role as President of BUMC, he oversaw a 1000+-bed not-for-profit academic medical center with over \$1 billion in annual revenue. He completed his DSc in Healthcare Administration and a MS in Health Administration from the University of Alabama Birmingham in 2012 and 1985, respectively. Dr. McWhorter is active in the community having served on various not-for-profit and community service boards and the Salvation Army Board, Greater Dallas YMCA Board of Directors, Need Him Ministries, Garland Chamber of Commerce, Dallas Chamber Health Councils, Southwest Transplant Alliance Board, and as Chairman of the Dallas Fort Worth Hospital Council. He is also active in the Park Cities Baptist Church and Buckner International.

FREDERICK SAVELSBERGH (58), *Executive Vice President, Chief Financial Officer and Treasurer*. Mr. Savelsbergh became associated with BHCS in 1982 and served as Chief Financial Officer of BHCS since 2008 prior to becoming Chief Financial Officer of BSW Holdings in 2013. Mr. Savelsbergh has held several executive positions, including Chief Financial Officer at Grapevine and BUMC, Interim President at Grapevine, and BHCS Senior Vice President of Hospital Finance. He obtained his BBA from the University of North Texas in 1982 and is a 2010 graduate of the Advanced Management Program at Harvard Business School. Mr. Savelsbergh's professional memberships include Healthcare Financial Management Association, where he is an advanced member of the Large Healthcare System CFO Council, Health Management Academy, and Financial Executives International. He was previously appointed by Texas Governor Rick Perry to the Texas Health Care System Integrity Partnership whose work has since concluded. Mr. Savelsbergh currently serves as a board member for the following organizations: Baylor Affiliated Services; Baylor Health Enterprises; Baylor Health Services; BHCS Holdings; Baylor Scott & White Assurance, SPC; Texas Health Ventures Group; Texas Health Ventures Group Bariatrics; Baylor Tenet East Dallas LLC; Baylor Tenet Garland LLC; HealthSHARE; and SharedClarity, LLC.

GARY D. BROCK (61), *Executive Vice President and Chief Integrated Delivery Network Officer*. Throughout his distinguished 29-year career, Mr. Brock has held many leadership positions, and previously served as Chief Operating Officer of the North Texas Division. As the Chief Integrated Delivery Network Officer, Mr. Brock provides direct executive leadership and oversight for several corporate services including office of strategy, new business development, network development, managed care, government relations, consumer affairs comprised of marketing and public relations, the BSWQA and HealthTexas Provider Network. He also served as President of Baylor Scott & White Medical Center - Garland, Senior Vice President of Managed Care and Physician Network Development for BHCS, and as President of HealthTexas Provider Network from its inception in 1994 until 2000. Mr. Brock holds a BA degree and a MPH degree from the University of Oklahoma and is a graduate of the Advanced Management Program at Harvard Business School. An active member of the health care profession, Mr. Brock currently serves as immediate past chairman of the Texas Hospital Association. He is also the chairman of the Texas Health Ventures Group board of managers and also serves on the boards of the American Hospital Association Regional Policy Board 7, the Dallas Regional Chamber and the BSWQA.

WM. STEPHEN BOYD (64), *Executive Vice President and Chief Legal Officer and Corporate Secretary*. A 1981 graduate of SMU Dedman School of Law, Mr. Boyd had 26 years of experience representing various regulated industries in federal and state courts as well as administrative venues prior to joining BHCS in 2007. Mr. Boyd was with the law firm of Worsham Forsythe & Wooldridge from 1981 until its joinder with Hunton & Williams in 2002, and he served as Managing Partner of the Texas offices of Hunton & Williams from 2004 to 2007. He has served the Dallas community for many years in various civic organizations, including the Salesmanship Club of Dallas, the Dallas Heritage Village, and the Committee for a Qualified Judiciary. He presently serves on the Board of Directors of SCF Charitable Properties and the Executive Board of SMU Dedman School of Law.

ROBERT PROBE (55), *Executive Vice President and Chief Medical Officer*. Dr. Probe assumed the role of Executive Vice President and Chief Medical Officer on February 1, 2016. In this role, Dr. Probe's focus is on the assurance of quality clinical service throughout the System while coordinating and integrating the diverse components of the medical practice. Prior to taking this position, Dr. Probe served as a member of the BSW Holdings Board of Trustees and the Chair of the S&W Clinic Board, which provides governance to S&W's 1,100 physician group practice. Clinically, Dr. Probe provided decades of orthopaedic trauma service to S&W Clinic's Level 1 Trauma Center while simultaneously providing national leadership in the discipline through his role on the Board of the Orthopaedic Trauma Association. Dr. Probe received his BS from Texas A&M University in 1982, and his MD from the Texas A&M College of Medicine in 1984.

JOHN LACY (49), *Executive Vice President and Chief Human Resources Officer*. Mr. Lacy joined the System in 2014 as the Chief Human Resources Officer for BSW Holdings. In this role, he oversees all human resource functions for the organization. Mr. Lacy comes to the System from Baptist Memorial Health Care Corporation in Memphis, Tennessee, where he served as vice president of human resources. He spent a total of fifteen years at Baptist Memorial Health Care Corporation in progressive leadership roles. Prior to his last role at Baptist Memorial, he held roles as senior vice president of human resources at Methodist Health System in Dallas, Texas, and senior vice president of human resources at Memorial Health Market, HCA in Jacksonville, Florida. Mr. Lacy received his BS in Business Administration from Christian Brothers University in Memphis, Tennessee, graduating *cum laude*, and earned an MBA from Union University in Jackson, Tennessee.

LAVONE ARTHUR (53), *Senior Vice President and Chief Integration Officer*. Ms. Arthur is responsible for coordination of activities related to the integration of BHCS and S&W, including providing project leadership and direction in developing and executing post-merger integration strategies. She is also responsible for business development, where she coordinates all aspects of new business transactions and joint venture arrangements. She began her career at BHCS in 1984 and previously served as Vice President, Financial Analysis and Decision Support Services, responsible for strategic financial and capital planning for BHCS, as well as providing financial and operational analysis support to all business units. Ms. Arthur is a Fellow and former national Vice-Chair of the Healthcare Information and Management Systems Society and an advanced member of the Healthcare Financial Management Association. She is past chair of the North Texas Healthcare Information & Quality Collaborative, an advisory council to the Dallas-Fort Worth Hospital Council Foundation on issues related to regional data assets, quality and patient safety. Ms. Arthur was named one of the Dallas Business Journal 2014 Women in Business Awardees, and has been named one of the Dallas Business Journal 2014 Who's Who in Healthcare. Ms. Arthur has a BS, Health Systems Engineering from the Georgia Institute of Technology and an MBA, Health Services Management from the University of Dallas.

FRANCIS P. ANDERSON, FHFMA (60), *Vice President of Finance, Chief Debt Officer and Chief Investment Officer*. Mr. Anderson has been the Vice President of Finance and Chief Debt Officer since the merger. Effective April 11, 2016, he will also assume the role of Chief Investment Officer. Mr. Anderson joined S&W in 1989. He served in many roles at S&W and prior to the merger was Senior Vice President and Treasurer, as well as Chief Compliance Officer for the S&W system. He serves as Board Member and Treasurer of the Continuing Care Hospital and as a Board Member for Scott & White EMS. Prior to joining S&W in 1989, Mr. Anderson worked in banking. Mr. Anderson, a Fellow of the Healthcare Financial Management Association, has served at the chapter, regional, and national level, is a past President of its Lone Star Chapter, and is a 2006 recipient of the Founders Medal of Honor. Mr. Anderson received his MBA, with a concentration in Finance, from Baylor University in 1987 and his BBA, with a major in Finance and Economics, from University of Mary Hardin-Baylor in Belton, Texas in 1985.

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DESCRIPTION OF THE SYSTEM

GENERAL INTRODUCTION

With the System's culture focused on the customer at the center of all its efforts, the System provides the full continuum of care to the communities it serves. The System, through the BSWQA, provides care coordination across the care continuum and standard treatment protocols that drive high patient quality outcomes and satisfaction.

The following describes the entities that comprise the hospital facilities of the System's Obligated Affiliates and other material entities within the System, including BSWQA, the Health Plan, the System's physician network and its medical staff.

DESCRIPTION OF THE OBLIGATED AFFILIATES

The System and its hospitals have a 13-county market area in North Texas (the "*North Texas Area*") consisting of Collin, Dallas, Denton, Ellis, Hood, Hunt, Kaufman, Johnson, Parker, Rockwall, Somervell, Tarrant and Wise Counties, and a 32-county market area in Central Texas (the "*Central Texas Area*") consisting of Bastrop, Bell, Blanco, Bosque, Brazos, Brown, Burleson, Burnet, Caldwell, Comanche, Coryell, Erath, Falls, Grimes, Hamilton, Hays, Hill, Lampasas, Lee, Leon, Limestone, Llano, Madison, McLennan, Milam, Mills, Montgomery, Robertson, San Saba, Travis, Washington, and Williamson Counties. The following describes the entities that comprise the hospital and clinical facilities of the Obligated Affiliates.

BAYLOR UNIVERSITY MEDICAL CENTER

BUMC is a tax-exempt Texas nonprofit corporation that owns and operates Baylor University Medical Center (the "*Baylor University Medical Center*"), a major teaching, research and tertiary and quaternary acute care hospital located on 110 acres in Dallas, Texas. The Baylor University Medical Center is a Level 1 Trauma Center and one of the largest hospitals in Texas, with 1,010 licensed beds as of December 31, 2015 (including the 96-bed cancer hospital), and is also one of the major referral centers in the region. The Baylor University Medical Center complex contains five major connected patient towers (Truett, Hoblitzelle, Jonsson, Pickens and Roberts) and a variety of specialty care centers, including the Charles A. Sammons Cancer Center at Dallas, the Harold C. Simmons Transplant Institute, the Leonard Riggs Level 1 Emergency Center, the H.L. and Ruth Ray Hunt Heart Center, the W.H. & Peggy Smith Baylor-Sammons Breast Center, and the Darlene Cass Breast Imaging Center. In August 2012, the System completed conversion of the former Collins building on the Baylor University Medical Center campus into the 96-bed dedicated cancer hospital building now known as Baylor T. Boone Pickens Cancer Hospital.

For the convenience of the Baylor University Medical Center's staff and patients, a number of medical office facilities (certain of which are owned and operated by outside third parties) are located on or adjacent to the hospital facilities. Two of these facilities, Wadley and Barnett Towers, are known as the Baylor Medical Plaza and contain leased physicians' suites, a hotel, and retail shops. Other office facilities, the Worth Street Tower, the Landry Tower, the Washington Street Tower, the Swiss Avenue Tower, the Baylor Heart and Vascular Hospital professional office building, and Baylor Medical Pavilion, are located on or adjacent to the Baylor University Medical Center's campus.

SCOTT & WHITE MEMORIAL HOSPITAL

Scott & White's main campus (the "S&W Main Campus") is located in Temple, Texas. Memorial Hospital is a leading teaching hospital and an acute care Level 1 Trauma facility with 614 licensed beds as of December 31, 2015 (including the 64-bed McLane Children's Hospital). The S&W Main Campus encompasses approximately 300 acres and is home to more than three million square feet of building space housing S&W's principal hospital and clinic facilities. Memorial Hospital and the principal clinic facilities (the "S&W Main Clinic"), along with numerous outlying buildings such as the Mental Health Center, the McLane Children's Campus (described below), the Dialysis Center, S&W Pavilion, and the Center for Diagnostic Medicine comprise the S&W Main Campus location. Memorial Hospital's facility also includes the state-of-the-art Center for Advanced Medicine as a digital, wireless, and integrated hospital facility. Memorial Hospital owns the S&W Main Campus, the facilities thereon, and most of the physical assets used in conjunction with the facilities. The S&W clinics are co-located with hospitals so that patients have access to multi-disciplinary care that allows for specialists and other caregivers to be available when and as needed.

The McLane Children's Campus on the S&W Main Campus (former location of King's Daughters Hospital) is currently home to McLane Children's Hospital and the 112,000 square foot McLane Children's Specialty Clinic. McLane Children's Hospital is a teaching hospital with 64 licensed beds as of December 31, 2015. The McLane Children's team also manages the specialty care of Memorial Hospital's 48-bed Neonatal ICU. With the opening of the Specialty Clinic in February 2014, the entire range of pediatric specialty and subspecialty care is now primarily served at the McLane Children's Campus. Pediatric specialty and subspecialty services are also delivered by the McLane Children's team to patients in each of the Central Texas Division's outlying regions. The McLane Children's Hospital fills a vital need for pediatric patients by being the only children's facility between the Dallas-Fort Worth Metroplex and Austin.

In May of 2016, this hospital is expected to be renamed Scott & White Medical Center – Temple, and following in the summer of 2016 McLane Children's Hospital is expected to be renamed Baylor Scott & White McLane Children's Medical Center.

BAYLOR SCOTT & WHITE HOLDINGS

BSW Holdings is the Texas nonprofit corporation that was formed in June 2013, began operations October 1, 2013, and is exempt from federal income taxation under Section 501(a) of the Code by virtue of being an entity described in Section 501(c)(3) of the Code. BSW Holdings serves as the ultimate parent entity for the System and provides the overall governance, strategic planning and related services for the System. BSW Holdings supports and guides the System in a manner that fosters greater access to quality, dependable, affordable and compassionate care within the communities served by the System.

BAYLOR SCOTT & WHITE HEALTH

BSW Health is a Texas nonprofit corporation that was formed in June 2013, began operations October 1, 2013, and is exempt from federal income taxation under Section 501(a) of the Code, by virtue of being an entity described in Section 501(c)(3) of the Code. BSW Health serves as the service company of the System and provides centralized administrative and management services such as finance, legal, human resources, risk management, and information services to the System.

BAYLOR SCOTT & WHITE ALL SAINTS MEDICAL CENTER – FORT WORTH

All Saints owns and operates a licensed hospital in Fort Worth, Texas. All Saints is a general acute care facility with 574 licensed beds as of December 31, 2015 and other health care related operations located on the southwest side of downtown Fort Worth, Texas.

BAYLOR SCOTT & WHITE MEDICAL CENTER – GRAPEVINE

Grapevine owns and operates a general acute care hospital with 313 licensed beds as of December 31, 2015 and other health care related facilities in Grapevine, Texas. The hospital became an affiliate of BHCS in September 1981 and opened an expansion with 40 built beds and space for 60 additional shelled patient rooms in July 2013.

BAYLOR SCOTT & WHITE MEDICAL CENTER – PLANO

Plano owns and operates a general acute care hospital with 160 licensed beds as of December 31, 2015. The primary focus is adult acute care with a strong focus on general surgery, orthopedics and neurosurgery. A full service joint venture heart hospital opened in January 2007 on the Plano campus.

BAYLOR SCOTT & WHITE MEDICAL CENTER – WAXAHACHIE

Waxahachie owns and operates a new acute care hospital with 104 licensed beds as of December 31, 2015 in Waxahachie, Texas. The new hospital replaced the prior facility which operated in Waxahachie, Texas for over 30 years. The new facility contains shelled space for 25 additional beds. The facility includes one interventional radiology room; seven operating room suites (four finished and three shelled); and a cancer center. The professional office building opened in February 2015, and was included in the overall project design.

BAYLOR SCOTT & WHITE MEDICAL CENTER – ROUND ROCK

The Round Rock campus is located in Round Rock, Texas and was established in 2007. The campus includes an acute-care hospital with 101 licensed beds as of December 31, 2015. The Round Rock hospital introduced much needed specialty expertise into Williamson County and North Austin supported by multi-specialty care offered in Temple. An 86,000 square foot medical office building containing subspecialty physicians is attached to the hospital and an additional 100,000 square feet of subspecialty physician office space exists in a medical office building located across the street from the main campus. There is also a network of 13 primary care clinics located in Round Rock and the surrounding communities.

BAYLOR SCOTT & WHITE MEDICAL CENTER – HILLCREST

Hillcrest Medical Center in Waco, Texas, is jointly owned by S&W (80%) and Hillcrest Health System, Inc. (20%). Hillcrest Medical Center has 576 licensed beds as of December 31, 2015, including an accredited acute care facility, an Inpatient Rehabilitation Unit and a Skilled Nursing Unit. Hillcrest Medical Center is a Level 2 Trauma Center and operates a Level 3 Neonatal Intensive Care Unit. There are also two medical office buildings and a comprehensive freestanding cancer center adjacent to the main hospital facility. Hillcrest Medical Center is also the sole corporate member of Hillcrest Family Health Center, which employs 34 primary care providers, and of Hillcrest Physician Services, which employs 54 specialty care providers in clinics around the Waco area. Hillcrest Medical Center has been a longtime leader in service to the Waco and surrounding communities.

SCOTT & WHITE HOSPITAL – COLLEGE STATION

The College Station campus, approximately 90 miles northwest of Houston, is located in Brazos County, Texas and was opened in August 2013. The 98-acre campus includes an acute-care hospital with 119 licensed beds as of December 31, 2015 and an adjacent four-story medical office building that holds the S&W Clinic – Rock Prairie. The hospital includes a nationally accredited Chest Pain Center. Services include an emergency department, comprehensive cardiac services, general and specialty surgery, imaging and radiology. S&W has augmented its services to patients in Brazos County with hospital care after being

a leader in clinical care for over 30 years. In April of 2016, this hospital is expected to be renamed Baylor Scott & White Medical Center – College Station.

BAYLOR SCOTT & WHITE CONTINUING CARE HOSPITAL

The Continuing Care Hospital is a long-term acute care facility located approximately five miles west of the S&W Main Campus location in Temple, Texas. The continuing care hospital had 50 licensed beds as of December 31, 2015. By providing long-term acute care services, the Continuing Care Hospital fills a void in central Texas for this specialized service.

SCOTT & WHITE CLINIC

The medical staffs of S&W's hospitals are composed almost entirely of physicians employed by the S&W Clinic who are members of the Texas A&M Health Science Center College of Medicine (the "*Texas A&M College of Medicine*") faculty. The S&W Clinic physicians provide charity care to identified hospital patients, and make up the preponderance of the supervising physicians for S&W's graduate medical education programs. The S&W Clinic operates on a portion of the S&W Main Campus and offers a number of special services and programs, which are available to all patients of S&W. These include medical and surgical subspecialties, magnetic resonance imaging, radiological services, lithotripsy, dialysis, laboratory services, and other ancillary services. The clinic is recognized as a leader in diagnostic and specialty care across the southwest United States.

In addition to the S&W Main Campus, the S&W Clinic operates approximately 80 regional facilities, located throughout the Central Texas Area. Additionally, the S&W Clinic operates four dialysis centers and a cancer center in Killeen, Texas. All of the facilities operated by the S&W Clinic are owned or leased by S&W or another System entity.

DESCRIPTION OF OTHER MATERIAL ENTITIES OF THE SYSTEM

The following describes entities that are material to the operations of the System but that are not members of the Combined Group. Each of these entities contributed 5% or more of the total operating revenues of the System for the fiscal year ended June 30, 2015 or are key in fulfilling the System's strategy to develop its integrated statewide delivery network. For financial reporting purposes, the financial statements of entities majority owned or controlled by BSW Holdings are consolidated in BSW Holdings' financial statements and the debt of such entities is reflected on BSW Holdings' balance sheet at 100% despite the ownership structure described below.

PHYSICIAN NETWORK

HealthTexas Provider Network HealthTexas has experienced tremendous growth and has made significant achievements in contributing to the transformation of the System's health care delivery. Highly integrated with BSW Holdings and its affiliates, the medical group and System work together to improve patient outcomes while achieving significant health care savings through evidence-based care, information technology and quality improvement.

HealthTexas is the basis of the overall strategy to serve and expand the North Texas Area for the System. HealthTexas is a multi-specialty medical group that employs over 900 physicians and 143 advanced practitioners in 315 care delivery sites in the North Texas Area. This medical group practice is comprised of 102 primary care centers; 213 specialty care centers which include 9 psychiatrist medicine centers; 9 hospitalist programs; 4 pulmonary critical care units; 8 liver outreach clinics; 5 heart failure outreach clinics; 2 kidney outreach clinics; 3 senior health centers; and a family practice residency program. In fiscal year 2015, HealthTexas reported more than 2 million patient visits. As of December 31, 2015, HealthTexas

managed approximately 33,000 covered lives. In 2010, HealthTexas was awarded the American Medical Group Association's Medical Group Preeminence Award and has been named an American Medical Group Association Acclaim Award Honoree in 2011, 2012, and 2014 making it one of the leading medical groups in the nation. HealthTexas's existing culture of data driven improvement, quality infrastructure and governance was the foundation for forming BSWQA.

Scott & White Clinic The S&W Clinic dates back to 1897, and is one of the nation's largest multi-specialty group practices providing adult and pediatric care. Its integrated, high-quality care is delivered by over 1,500 total providers, with 1,155 physicians and 418 advanced practice professionals. These physicians include approximately 150 primary care physicians, 100 hospitalists, 60 general pediatric physicians with 40 pediatric specialists, 95 surgical specialists, and 200 physicians in the department of medicine.

In addition to the S&W Main Campus, the S&W Clinic operates approximately 80 regional facilities located throughout the Central Texas Area. Additionally, the S&W Clinic operates four dialysis centers and a cancer center in Killeen, Texas. All of the facilities operated by the S&W Clinic are owned or leased by S&W or another System entity.

BAYLOR SCOTT & WHITE QUALITY ALLIANCE

BSWQA is an accountable care organization, comprised of physicians, hospitals, post-acute care facilities and other health care stakeholders across both North and Central Texas who are committed to delivering high-quality, cost-effective, value-based care. BSWQA is owned by certain member hospitals with certain powers reserved to BSW Holdings. Its mission is to achieve the highest quality and most cost-effective care possible for the patients it serves through clinical integration. In an effort to reduce waste and redundancy, BSWQA utilizes health information technology that includes an electronic health record system and data analytics to provide a holistic, longitudinal view of its patients across the care continuum. As of December 2015, BSWQA managed the health of approximately 277,900 covered lives attributed from its commercial payers (including the North Texas Division employee health plan as well as Medicare advantage and the Medicare shared savings program). This total includes approximately 28,400 covered lives as of December 2015 that are also reported below for the Health Plan. The five-year strategic plan for BSWQA has a goal of managing over 600,000 lives.

Focused on (1) improving quality, (2) enhancing the patient experience, and (3) reducing per capita health care costs (collectively, the "*Triple Aim*"), BSWQA has been instrumental in leading the System's strategies to become an ACO and in advancing the System's population health initiatives across the State of Texas. BSWQA is leading the System's implementation of population health strategies deemed necessary for successful clinical integration and care delivery focused on predictive, preventive and personalized care. Since its formation, BSWQA has successfully executed the three key strategies deemed essential to care management and, ultimately, clinical integration: (1) Patient-Centered Medical Home ("*PCMH*"), (2) Data Analytics, and (3) Care Coordination.

PCMH PCMH promotes a model of care that strengthens the clinician-patient relationship by focusing on coordinated care and managing the health of patient populations. PCMH may lead to quality improvement in care and cost reductions in administering that care. The NCQA PCMH recognition is the most widely-used way to transform primary care practices into medical homes and PCMH standards were developed by NCQA in conjunction with the four specialty societies to reflect a commitment to access and communication, care management, patient education, performance reporting and improvement. BSWQA currently has approximately 146 NCQA recognized PCMHs representing 645 physicians across both North and Central Texas.

Data Analytics BSWQA utilizes high-powered data analytics to refine algorithms and generate actionable patient data that is then distributed to care managers and physicians. Proactive patient engagement is achieved using risk-stratification and predictive modeling using data integrated from multiple sources (inpatient and outpatient electronic health records, claims data, and practice management systems) to identify high-risk patients, predict those patients with a high probability of a risk occurrence (rising-risk) and identify those in need of wellness exams and preventive services (low-risk). Appropriate care resources are then allocated based on a patient's category of risk.

Care Coordination BSWQA's Comprehensive Care Management team is made up of RN Care Managers, MA Health Coordinators, and Licensed Social Workers that engage and empower patients in managing their health collaboration with the physician so that positive health outcomes are achieved. BSWQA's centralized care coordination supports complex care management for high- and rising-risk patients and for high-risk transitions of care from the hospital to home. Through shared decision making and motivational interviewing techniques, BSWQA care managers work with the patient and the physician to deliver the tools patients need to reach their individual health goals. Integral to the care coordination model is ongoing communication with the patient's primary care physician, as well as collaboration by care coordination staff with specialists and other sites of care. Coordination extends into post-acute care ("PAC") where BSWQA partners with providers to gather additional information through monthly self-reported data to its performance dashboard. BSWQA expects to implement a PAC dashboard during fiscal year 2016 that shows claims-based outcome data and spend by payer type, level of care and specific post-acute agency which will be critical for increasing accountability and collaboration with BSWQA's partners. In addition, the development for the Central Texas PAC network has begun and is on track to be completed in 2016.

Population Health Generating Positive Outcomes BSWQA two-year results show notable improvements in important population health measures that include a 10% drop in all-cause readmissions, a 9% decrease in admits per 1,000, and a 6% reduction in medical plan costs for the North Texas Division employee health plan.

In addition, beginning in fiscal year 2014 BSWQA physicians working collaboratively and accountably have met every one of the quality thresholds as outlined in all BSWQA managed care contracts. These contracts resulted in total shared savings of approximately \$26 million generated over fiscal years 2014 and 2015.

SCOTT & WHITE HEALTH PLAN

In January 1982, the Health Plan launched operations as a not-for-profit health maintenance organization focused primarily in Bell and Coryell Counties. Today, the Health Plan has evolved into a vast health care network including SeniorCare, a Medicare HMO Cost Plan and a Medicare Advantage Plan, as well as a wide array of commercial plans, self-insured plans, income protection plans, and RightCare, a Medicaid plan.

In conjunction with the growth in product offerings, as of December 31, 2015 the Health Plan contracted with more than 8,500 physicians and 90 hospitals in its 77 county service area to deliver programs to approximately 220,000 members in Texas. Of those members, approximately 53% were commercial risk members, approximately 20% were Medicaid members, approximately 14% were Medicare members, and approximately 13% were self-inured or administrative services only members. For the fiscal year ended June 30, 2015, the Health Plan comprised approximately 9.7% of the System's operating revenues and 10.7% of the System's expenses.

A major factor in the Health Plan's growth has been the pursuit of member satisfaction and quality. The Health Plan is fully accredited by the NCQA. According to the NCQA Private Health Insurance Plan and

Medicare Health Insurance Plan Rankings, 2014-2015, the Health Plan leads all health plans in Arizona, New Mexico, Texas, Oklahoma, Louisiana and Alabama in national rankings for Medicare HMO products and private health insurance. Furthermore, according to the Office of Public Insurance Counsel “Guide to Texas HMO Quality 2014,” the Health Plan has the highest rating in Texas, exceeding national and Texas averages, for childhood immunization, comprehensive diabetes care, postpartum care, colorectal cancer screening rate, breast cancer screening rate, cholesterol management, and physician board certification rates. The Health Plan offers a number of innovative programs that provide a combination of preventive health and management of chronic disease, including a wide range of clinically integrated programs for the Health Plan’s members. These programs are designed to engage members in a healthy lifestyle and determining their own care. They support and coordinate care to the right place, at the right time, with the right provider, especially for those members with complex or chronic care issues. These programs include the VitalBridges discharge outreach program, the Maternal Options Maintenance Support (MOMS) program, and the online Succeed Health Risk Assessment.

TEXAS HEALTH VENTURES GROUP, L.L.C. (“THVG”)

THVG is a limited liability company with a majority ownership by BUMC and minority ownership by USP North Texas, Inc., a wholly-owned subsidiary of United Surgical Partners International (“USPI”). Joel Allison, Chief Executive Officer of BSW Holdings, serves on the USPI board. THVG has controlling ownership interests in 27 ambulatory surgery centers (“ASCs”) and eight short-stay surgical hospital partnerships (collectively the “THVG Entities”) in the North Texas Area with 228 licensed beds as of December 31, 2015. Each THVG Entity is also minority owned by qualified physician investors as limited partners, in varying percentages. THVG has entered into a management and royalty contract with each THVG Entity. THVG subcontracts with USPI for most day-to-day operations support and with BHCS for certain limited services. Each THVG Entity pays management and royalty fees to THVG, which are then apportioned between USPI and BHCS, pursuant to an agreement among USPI, BHCS and THVG.

USPI’s ownership in THVG is reported in unrestricted non-controlling interests—nonredeemable in net assets unless the equity interests are subject to repurchase provisions under the terms of its investees’ partnership and operating agreements.

TENET HEALTHCARE JOINT VENTURE

In January 2016, the System and Tenet Healthcare Corporation (“Tenet”) entered into two joint ventures to provide care through five North Texas hospitals. The joint ventures will focus on delivering integrated, value-based care to communities in Rockwall, Collin and Dallas Counties. Through these new joint ventures, the two organizations will jointly own Centennial Medical Center, Doctors Hospital at White Rock Lake, Lake Pointe Medical Center, Texas Regional Medical Center at Sunnyvale and Baylor Scott & White Medical Center - Garland. The System will hold a majority ownership interest in the entities operating the five hospitals, and all five will eventually operate under the Baylor Scott & White Health brand. These joint ventures will add more than 2,200 affiliated physicians to the System which are not otherwise reflected in the System’s physician count in this APPENDIX A.

BTDI JV, LLP (“BTDI JV”)

BTDI JV is a Texas limited liability partnership owned 51% by BUMC and 49% by Touchstone Imaging of Mesquite, LP, a wholly-owned subsidiary of Touchstone Medical Imaging (“Touchstone”), that was formed for the purpose of owning and operating outpatient imaging centers as part of an integrated health care delivery system affiliated with BSW Holdings. Pursuant to a contribution agreement that closed on July 2, 2013, BUMC contributed 13 outpatient imaging centers to BTDI JV and Touchstone contributed 15

outpatient imaging centers and cash. Touchstone is a privately held company specializing in the provision of diagnostic imaging services and provides management of day-to-day operations of BTDI JV.

EBD JV, LLP (“EBD JV”)

EBD JV is a Texas limited liability partnership between BUMC and Emerus Investment Company II, LLC, a wholly-owned subsidiary of Emerus Holdings, Inc. (“*Emerus*”), that was formed for the purpose of owning, operating and managing licensed hospitals focused on providing high quality and cost effective emergency medical care services to patients in North Texas as part of an integrated health care delivery system affiliated with BHCS. EBD JV is owned 51% by BUMC and 49% by Emerus. Pursuant to a contribution agreement that closed on July 1, 2012, contributions of cash and 100% of the interests in a licensed hospital operated by Emerus in Aubrey, Texas (now known as Baylor Emergency Medical Center at Aubrey) were made to EBD JV.

BIR JV, LLP (“BIR JV”)

BIR JV is a Texas limited liability partnership between Baylor Institute for Rehabilitation at Gaston Episcopal Hospital (“*BIR*”) and Select Physical Therapy Texas Limited Partnership, a wholly-owned subsidiary of Select Medical Corporation (“*Select*”), which was formed to provide rehabilitation services in the Dallas-Fort Worth Metroplex. Select is a publicly traded corporation that is one of the largest rehabilitation providers in the U.S. Pursuant to a contribution agreement that closed on April 1, 2011, BIR contributed an existing 92-bed freestanding inpatient rehabilitation hospital and 11 outpatient adult physical medicine clinics and Select contributed a 44-bed freestanding inpatient rehabilitation hospital, 19 outpatient rehabilitation clinics and cash. On March 1, 2012, BIR JV acquired 80% of the partnership interests in two inpatient rehabilitation hospitals located in North Dallas and Fort Worth, Texas. The remaining 20% partnership interests in these hospitals are owned by local physician investors. It is expected that Baylor Institute for Rehabilitation at Northwest Dallas, one of BIR JV’s hospitals, will wind up operations in mid-May 2016 and close June 1, 2016.

CLEVELAND CLINIC AFFILIATION

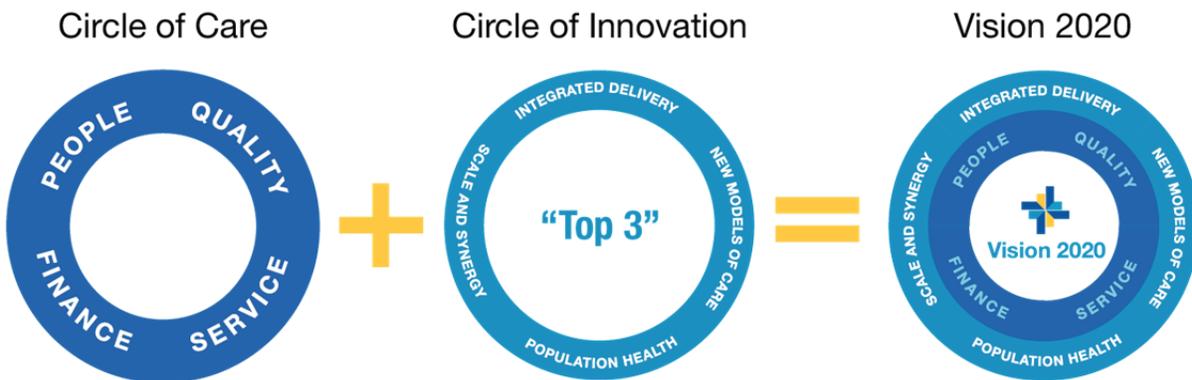
In December 2014, the System announced its exclusive affiliation with the Cleveland Clinic Foundation in the areas of cardiovascular medicine and cardiovascular surgery in Texas and Oklahoma. Three of the System’s hospitals – Baylor Jack and Jane Hamilton Heart and Vascular Hospital, BUMC and The Heart Hospital Baylor Plano – formed an academic, clinical and research affiliation with Cleveland Clinic’s Sydell and Arnold Miller Family Heart & Vascular Institute. The affiliation provides payers and employers with quality and cost certainty through a global bundled payment structure for heart surgeries and also enhances patient referrals, quality and research programs at the System. The affiliation enables access to world-class heart surgery in North Texas and serves as a key element of the System’s population health management strategy, while also meeting increased demand for quality and cost consistency, predictability and transparency.

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STRATEGIC INITIATIVES

VISION 2020

Vision 2020 represents the System’s aspiration to be one of the “Top 3” health care systems in the nation. Together, the Circle of Care and the Circle of Innovation provide the framework for setting goals and developing strategy as the System moves into population health management as a fully integrated statewide delivery network.



The Circle of Care, the framework for setting System goals, comprises four focus areas:

- *People*: Be the best place to deliver and receive high-quality care.
- *Quality*: Practice evidence-based and patient-centered care.
- *Service*: Deliver value to the System’s patients and the System’s communities.
- *Finance*: Be responsible financial stewards.

The Circle of Innovation represents how the System will achieve Vision 2020.

- *Financial Strength*: Maintain financial strength and capital capacity needed to fund mission and future.
- *Centers of Excellence*: Develop nationally recognized centers of excellence through the consistent delivery of high-quality health care supported by research.
- *Integrated Delivery Network*: Continue the process of becoming a fully integrated and digitally connected delivery system and building the competencies for population health management.
- *Strategic Growth*: Integrate the capabilities of BSWQA and the Health Plan to create an engine for future strategic growth.

The System is focused on four strategic priorities developed through the Circle of Innovation framework and measured and evaluated using the Circle of Care tools to advance Vision 2020. These strategic priorities are:

- Advancing Population Health and Creation of a Statewide Network;
- Operational Excellence Centered Around the Circle of Care;
- Consumer Digital Experience; and
- People and Culture.

ADVANCING POPULATION HEALTH AND CREATION OF A STATEWIDE NETWORK

BSWQA and the Health Plan (see “Description of Other Material Entities of the System” for information on BSWQA and the Health Plan) are aligning their core competencies in network development and access, physician and patient engagement, PCMH, data analytics and comprehensive care management to drive the System’s population health strategy and performance measurement. An example of the collaboration between BSWQA and the Health Plan to enhance the System’s population health mission is the January 2014 agreement for a Medicare Advantage Shared Savings program that cares for over 2,000 members as of December 31, 2015. Additionally, in March 2015 the Health Plan and BSWQA began marketing Baylor Scott & White Preferred – a commercial ACO jointly branded health plan product – in the Dallas-Fort Worth market. The expected potential customers include small, mid, and larger plan sponsors. The Baylor Scott & White Preferred product was designed by utilizing the strengths of both the BSWQA and the Health Plan, including components such as benefits design, user digital interface and customer service, care coordination, risk stratification and predictive modeling and claims management.

INTEGRATED DELIVERY NETWORK

BSWQA and the Health Plan are leading the System’s efforts to grow and enhance BSW Holdings’ integrated delivery network (“IDN”) across the State of Texas by merging the strengths of both entities to realize potential synergies and more cost-effectively care for the System’s patient population. Core components to deploying the IDN include physician engagement infrastructure, comprehensive disease management, statewide network contracting, joint shared savings commercial product offerings, integrated sales and marketing, a single cohesive patient experience, aligned payment mechanics and reduced costs through operational excellence. The System’s goal is to develop a leading edge infrastructure to advance and implement its IDN and has developed Centralized Network Support (“CNS”) to formalize four key areas of expertise for effective population health management and driven by an integrated data platform, common IT tool set, predictive analysis and care coordination support. The four competencies are: (1) Care Management; (2) Predictive Modeling and Financial Risk Management; (3) Clinical Integration and Value Performance; and (4) Patient Engagement.

Care Management Care management builds on the foundations of the PCMH and care coordination models deployed in the BSWQA and includes the coordination of complex, post-acute, and chronic disease and care management that is driven by aggregate data collection and provider reporting run under segmentation and risk prediction models to most effectively provide patient care.

Predictive Modeling and Financial Risk Management Predictive modeling and risk stratification using data integrated from multiple sources (inpatient and outpatient electronic health records, claims data, and practice management systems) are key to resource allocation for patient care and also incorporates cost and utilization analytics, prediction feedback looping, financial risk accounting/reporting, contract management and clinical documentation and coding improvements.

Clinical Integration and Value Performance The System is focused on removing costs and streamlining the continuum of care. Clinical integration takes place across the delivery network through consistent and communicative governance and strategic alignment across the network. Best practices for clinical quality and pathways are implemented and spread through service line councils. There is ongoing physician education and clinical operations improvement to optimize quality and cost and proven strategies to transform practices to the System’s high performance standards. Common IT tools allow for performance analysis and clinical integration across the spectrum of the System’s wholly-owned, joint ventured or partnered facilities.

Patient Engagement Patient engagement is the focal point of population health and the culmination of the three other major components of CNS. The System's strategy includes patient navigation tools with cost transparency, self-managed health/engagement/information and attribution, appointing, and access management.

OPERATIONAL EXCELLENCE CENTERED AROUND THE CIRCLE OF CARE

The System is committed to quality at every point of the patient experience. Building upon the foundations of clinical excellence through Accelerating Best Care ("ABC"), Lean and Six Sigma quality improvement approaches, the System has been able to deliver health care that is safe, timely, effective, efficient, equitable and patient-centered ("STEEEP[®]").

Additionally, the System's focus on clinical and operational excellence have had a positive financial impact on revenue and cost saving initiatives. Since inception of the merger through December 31, 2015, operating revenue and operating expense savings have totaled approximately \$279 million and post-merger synergies have totaled approximately \$227 million for combined operational savings and synergies of approximately \$506 million. The realized \$227 million of synergies represents approximately 40% of the System's five-year target of \$577 million. Both operational and synergy savings initiatives are ahead of identified target levels.

A few examples of key operational initiatives and programs are below:

BILL ASTON QUALITY IMPROVEMENT PROGRAM

Each year, through the System's Bill Aston Quality Improvement Program, multidisciplinary teams across the System utilize rapid-cycle improvement methods and tools to improve and sustain best care practices. The System recognizes the top four projects aligned with the Circle of Care areas of people, quality, service and finance. In 2015, those projects included:

Overtime Reduction Within a Multidisciplinary Ambulatory Cancer Center (People)

On the Hillcrest Medical Center campus, 37 team members across eight departments provide oncology patient care at the Baylor Scott & White McClinton Cancer Center. The team's cumulative overtime hours averaged 31 hours per week—incurring budget variances, as the goal is 10 overtime hours per week. The project reduced weekly overtime hours, resulting in reduction of average monthly overtime expenses from \$5,583 per month to \$2,598 per month, while team member work satisfaction increased.

Enhancing Care at the End of Life Through Transition to Hospice (Quality)

In an effort to enhance care at the end of life, All Saints developed a process for critical care patients to transfer to the VITAS Hospice Inpatient Unit on the All Saints campus for withdrawal of life sustaining treatments. When the project began, no patients were agreeing to transfer to the hospice for planned withdrawal of life sustaining treatment. By project's end, more than 70% of patients were agreeing to transfer to VITAS.

Speeding Up the Process – Improving Scheduling for Outpatient Oncology Imaging Procedures (Service)

A critical component of excellent patient care is providing timely responses, particularly for cancer patients, as imaging is often vital in directing treatment. The project team implemented several process changes that resulted in decreasing wait times for diagnosis or treatment by eight days. Now, the time to schedule these procedures takes less than a day.

Reducing Direct Cost and Length of Stay on Total Joint Patients by an Outcomes Manager-Led Interdisciplinary Team (Finance)

Controlling costs while maintaining high quality outcomes and reasonable reimbursements is essential for the System and the patients it serves. This is especially important as the number of total knee (“TKA”) and total hip (“THA”) replacement procedures increases each year, and insurers push for lower costs and improved outcomes while Medicare and Accountable Care Organizations are beginning to link reimbursements with quality measures and patient outcomes. Recognizing this, the project team focused on improving the continuum of care with interdisciplinary collaboration.

Results included achieving:

- Reduced direct costs: TKA by 4.8% and THA by 8.7%
- Reduced average length of stay: TKA by 20.9% and THA by 16.2%
- Increased number of patients going home in one day: TKA patients from 4% to 25% and for THA patients from 5% to 17%
- Increased patient satisfaction: by 2.4%

SERVICE LINE AND GOVERNANCE COUNCILS

Service line and governance councils are examples of structural organizational bodies that develop criteria and governance models for service line centers of excellence across the System. Each service line council includes an executive sponsor and one or more representatives from medical/clinical, administration, and finance. Service line councils range from Cancer to Behavioral Health.

CONSUMER DIGITAL EXPERIENCE

Technology is rapidly changing the way consumers and health care providers connect, which has enabled the development of new and innovative solutions that enhance the patient experience and support wellness and quality health care. The System is integrating these new technologies, programs and resources into the health information technology infrastructure through the Consumer Digital Experience. This initiative is enhancing the way consumers discover, decide and connect with the System; improves wellness and care outcomes through digitization and analytics; and enables support for specific measures for availability, geographic use and capacity needs. The Consumer Digital Experience includes video visits, mobile device apps and patient portals, putting a variety of health and wellness tools into the patient’s hands.

The growth strategy in this area is to create a virtual health capability where users can book an appointment, be treated on demand through a video or electronic visit, assemble their information and personalized profile, and find out where the nearest urgent walk-in clinic might be. It is access to the System’s care made simple. Examples of the tools, applications and resources the System leverages include:

HealthSource An interactive app that allows consumers to check symptoms, find providers, track health records, share records with providers, and have live, video visits with a health care provider from a laptop, smartphone or other smart device. Scheduling is easy, and HealthSource is a convenient alternative for busy parents and others who have non-life threatening conditions. HealthSource also interfaces with the Health Plan to allow users to view coverage, claims, deductibles, and access insurance cards.

Telehealth Telehealth comes in many forms such as monitoring simple data (like heart rate) that patients can send, to the ability to diagnose complex health issues through a variety of interactive tools and capabilities, and beyond to health education and wellness information. Current telehealth offerings include: (i) tele-psychiatry; (ii) tele-medication therapy management; (iii) tele-chaplaincy; and (iv) tele-oncology.

Listening Center The System has implemented a Social Media Listening Center, which will monitor traffic on social media sites where the System is mentioned. Social media has become a new channel for consumers to provide reviews, post complaints and otherwise engage with health care systems. The listening center enables the System to respond within minutes to questions, complaints or feedback from consumers. Through the listening center, the System can now engage more effectively and efficiently with 10 times the number of consumers.

PEOPLE AND CULTURE

The System's vision is to be the most trusted name in giving and receiving safe, quality, compassionate health care. Achieving the System's vision can only be accomplished by utilizing its most valuable asset, the System's employees. The System's people have a calling to serve patients, and leadership has a calling to serve the System's team members. The System's "patient first" philosophy and placing the patient at the center of everything the System does is what drives and enhances its special organizational culture.

The Circle of Care guides the measurement, recognition and reward of employees and reflects the System's strong culture. The four Circle of Care criteria (see "Vision 2020" above) are defined for measurement and performance reporting. For example, under the People criterion, the System measures employee retention as a System-wide measurement goal. Coordination and collaboration between the North Texas and Central Texas team members has been successful post-merger. Councils and departments have been integrated and are working together on many important aspects of patient care. Nursing councils, integrated research teams, and affiliations within and outside of the System are generating notable breakthroughs, methods, procedures and improved outcomes for individual patients and the health of populations and communities at large.

The System strives to be recognized as one of the best places to work in health care and listening to and responding to its employees is an important component in this endeavor. The System incorporates initiatives and programs to support and enhance the strong culture, such as the People Survey, the "Welcome Home" new employee orientation, and daily huddles that quickly solve problems and promote good ideas to the benefit of the workplace and, foremost, the System's patients.

CAPITAL PLANNING AND INFRASTRUCTURE PROJECTS

The System's capital plan reflects its strategic initiatives. As part of the ongoing strategic planning process, management regularly assesses near-term and long-term capital requirements in developing its statewide integrated delivery network including both growth opportunities and replacement needs. Management also assesses strategic opportunities beyond the existing facilities for growth and in order to improve access to care in the communities the System serves.

Capital expenditures for the System may include wholly-owned hospital and clinic and existing joint venture and partnership expansions, new joint ventures, physician practice development and acquisitions, adoption of new technologies, and network expansion. The capital plan includes several projects expected to be or currently underway across the System, including critical care and perioperative services expansions at Baylor University Medical Center in Dallas, an emergency department expansion at All Saints in Fort Worth, and expansion of Memorial Hospital's Surgical Sciences Building in Temple. The plan does not include potential mergers and acquisitions as they are opportunistic in nature. Before any individual project is commenced or significant capital costs are incurred, it is evaluated internally to determine financial feasibility and alignment with the System's strategy, mission and values. Management expects that the sources of funding for capital projects through fiscal year 2018 will be a combination of bond proceeds and cash from operations.

MERGERS, ACQUISITIONS AND DIVESTITURES

GENERAL

In order to continue to realize its objectives, the System holds discussions with respect to mergers, affiliations, joint ventures, and acquisitions and divestitures of facilities in the areas that it serves, including those that may impact the Combined Group, intermittently and usually on a confidential basis with the other parties. In connection with such activities, the System or other Combined Group members may provide financial support or arrange for funding for such transactions, and such transactions may change the structure, operation and performance of the System described herein.

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OTHER SYSTEM COMPONENTS

Medical Staff The System does not have a System-wide medical staff but appointments, re-appointments and credentialing are managed through a central office in both divisions using a consistent process. Each separately licensed affiliated hospital has a separate medical staff unique to that hospital, although there are a number of physicians and dentists who are on the medical staff of one or more System hospitals. The System includes more than 6,600 total physicians. As of December 31, 2015, there were 3,984 physicians and dentists who hold Active medical staff membership at one or more System facilities, and 3,532 physicians and dentists who hold Active-affiliate, Courtesy or Consulting medical staff membership at one or more System facilities. For these purposes, “Active” is generally defined to mean physicians and dentists who have active-clinical, active, associate attending, associate, attending, provisional or provisional-active privileges who regularly perform a major part of their hospital medical practice at a System inpatient facility; “Active-affiliate” is defined as a practitioner that does not have patient contact; “Courtesy” is generally defined to mean physicians and dentists who qualify as Active medical staff members, but use System facilities to a limited extent; and “Consulting” membership is limited to the hospitals that operate under partnership agreement or that offer a limited line of clinical services and does not include admitting privileges.

MEDICAL SERVICES

The System offers a full range of inpatient and outpatient diagnostic and therapeutic services and related ancillary services. The System’s inpatient services include all major categories of medicine and surgery. Specific service lines provided in the North Texas Division and the Central Texas Division as of December 31, 2015 are set forth below:

| | |
|---|---------------------------------|
| Anesthesiology | Orthopedics |
| Dermatology | Pathology |
| Emergency Medicine | Pediatrics |
| Family Medicine | Physical Med and Rehabilitation |
| Internal Medicine | Psychiatry |
| Neurology | Radiation Oncology |
| Obstetrics and Gynecology | Radiology |
| Occupational Medicine (Central Texas Division only) | Surgery |
| Ophthalmology | |

MEDICAL RESEARCH

RESEARCH

The System promotes and supports its scholarly mission through both basic and translational research activities to ensure innovative treatments are quickly available to patients in unique need through the Baylor Scott & White Health Research Institute (“BSWR”) and its laboratories. Research includes pharmaceutical studies ranging from early development cancer to efficacy of the nasal flu vaccine. New areas of health services research focusing on methods of care for the nation’s aging population have also recently been initiated. Basic research includes areas of infectious disease, auto-immune disease, metabolomics and oncology.

In fiscal year 2015, the System's award-winning scientists and medical professionals conducted more than 1,781 active research protocols in more than 60 medical specialties including immunology, cancer, cardiovascular, transplantation and metabolomics throughout the System. BSWRI staffs approximately 553 employees in more than 243,000 square feet of research space. BSWRI's research is frequently published in major scientific journals including the Journal of the American Medical Association, the American Journal of Cardiology, Cell, and the Journal of Neuroscience, and is presented and cited at medical and scientific meetings throughout the world. The science has generated over 680 issued and pending patent applications in Immunotherapy, Genomic/Biomarkers, Metabolomics/Metabolic, Cardiovascular Disease and Medical Devices.

In fiscal year 2016, BSWRI's total research budget is over \$91 million and anticipated to grow to over \$100 million in fiscal year 2017. The research budget is funded from a variety of sources, and in fiscal year 2016 the funding was budgeted as follows:

- Industry (36%)
- Support from the System (33%)
- Philanthropy (17%)
- Government sources (14%); including National Institutes of Health, the Agency for Healthcare Research and Quality and State of Texas CPRIT program

Biomedical Research Collaboration with Baylor College of Medicine In January 2016, Baylor College of Medicine ("BCM") and the System entered into an agreement to expand biomedical research in North and Central Texas. A search committee is being established to recruit a Chief Scientific Officer, who will oversee the collaborative effort and all of BSWRI's laboratory science and serve as a section chief in the BCM Department of Medicine. The collaboration will be governed by a Research Oversight Council, composed of eight members, equally representing both institutions. New faculty will be hired in both Dallas and Temple (BSWRI locations) and BCM faculty and current BSWRI faculty will transition to BCM faculty appointments over time.

Partnership with Translational Genomics Research Institute Another initiative, with the objective to close the translation gap from world-class medicine and innovative science, is with the Translational Genomic Research Institute in Phoenix Arizona ("TGEN"). The BSWRI and TGEN research vision is to improve patient outcomes through genomic, proteomic, metabolomics and immune-directed clinical and translational research. The institutes have developed a combined center of excellence for Oncology Research conducting flagship research studies in Abdominal, Women's and Hematologic cancers with the potential in the future to be applicable to other disease areas and service lines.

Immunotherapy BSWRI is also a world-renowned leader in the field of dendritic cell ("DC")-based immunotherapy and DC-based therapeutic vaccines. Investigators are developing next-generation immunotherapy platform. A key strategic focus of development relates to head and neck cancers, where 30% are associated with HPV16 infection. In efforts to accelerate development of BSWRI-owned protein-based immunotherapies and with the mission to bring innovative medicines to patients in need, proof of concept clinical trials in cancer, infectious and autoimmunity are being led by BSWRI in collaboration with industry partners. These collaborations are combining the best of BSWRI expertise in scientific, intellectual property, protein manufacturing and clinical trials with new funding mechanisms and industry expertise from industry partners.

MEDICAL EDUCATION

The System is committed to medical education in support of its mission of exemplary care, education and research. The Texas A&M College of Medicine and the System have established Clinical Training Programs, at which medical students complete clinical rotations at Baylor University Medical Center and Memorial Hospital. Central Texas Veterans Health Care System is a major clinical partner in Temple and helps to train the System's residents and medical students. Because of this affiliation the System's trainees are able to better identify the needs of Veterans and their families. Nursing education is conducted through programs and affiliations with numerous schools of nursing including University of Mary Hardin-Baylor, Texas A&M University-Corpus Christi, Baylor University School of Nursing, Dallas County Community College District, Texas Woman's University and the University of Texas at Arlington. A number of these students remain with the System as employees following their training and education. Training and education is structured with the following major components:

PHYSICIAN MEDICAL EDUCATION

The System's education for physicians consists of Graduate Medical Education (Residents and Fellows) and Undergraduate Medical Education (Medical Students), as well as Continuing Medical Education services. The System supports Graduate Medical Education by offering over 80 residencies and fellowship programs from Dallas to Temple and as of December 31, 2015 had over 750 physicians in training. All programs are accredited by the Accreditation Council for Graduate Medical Education, the Texas Medical Board or other appropriate accrediting agencies, and the training is recognized by the corresponding specialty boards.

The System supports Undergraduate Medical Education through its affiliations with the Texas A&M College of Medicine. Over 300 second, third and fourth year medical students receive their clinical training within the System annually. Many other medical schools from around the country send their students for elective rotations to the System. Continuing Medical Education services are provided by the System for its practicing physicians and other physicians both regionally and nationally. These programs support physicians that provide the most up-to-date clinical, academic, and research information so that the System's physicians remain at the forefront of quality health care and are accredited by the Accreditation Council for Continuing Medical Education. With more focus on patient safety and quality, at Baylor University Medical Center and Memorial Hospital, the System has established House Staff Quality Councils that work hand in hand with other health care professionals to meet the System's needs of giving and receiving safe, quality, compassionate health care to all. Both Baylor University Medical Center and Memorial Hospital participate in national initiatives sponsored by the Alliance of Independent Medical Centers. The focus of such initiatives includes patient safety, transitions in care and health care disparities.

With the enormous growth taking place in Round Rock and Austin and the need to provide more primary care physicians, the System is currently developing new Family Medicine and Internal Medicine residency programs that are expected to begin the training of new physicians in the Fall of 2017. Further exploration of other primary care sites in North Texas is anticipated to be undertaken soon.

NURSING PROGRAMS

In addition to training physicians, the System recognizes the important roles played by nurses, nurse practitioners, physician assistants, pharmacists and others in the overall team approach to quality population health care. Campuses in the Central Texas Division serve as the clinical campus for the Scott & White School of Nursing at the University of Mary Hardin-Baylor through a baccalaureate degree program. In addition, Memorial Hospital and the S&W Main Clinic also facilitate the clinical training of registered nurses and licensed vocational nurses in conjunction with Temple College, McLennan Community College, and Central Texas College. A Master's of Science in Nursing program is also available on the S&W Main

Campus through Texas A&M University-Corpus Christi. Nursing education is also conducted through more than 30 affiliations with numerous schools of nursing in the Dallas-Fort Worth region and throughout the country, including Baylor University School of Nursing, Dallas County Community College District, Texas Woman's University, Texas Christian University, University of Texas at Tyler, Texas Tech and The University of Texas at Arlington. Many of the universities have partnerships with the System that provided tuition discounts. In addition, both divisions have partnered with schools to establish joint, adjunct, or shared faculty appointments of System employees to assist in teaching nursing. In total, more than 4,600 nursing students rotate through the various System campuses and affiliated nursing programs annually.

ALLIED HEALTH PROFESSIONAL PROGRAMS

The System hosts allied health-training programs in affiliation with various universities within Texas and throughout the southwest United States. Examples of those areas of training include: allied health sciences/health administration, medical technology, occupational and physical therapy, pharmacy, radiological technology, respiratory therapy, social work, and speech pathology. The System currently trains approximately 50 physician assistant students. The System has affiliation agreements with Baylor College of Medicine, UT Southwestern, University of North Texas and others, including 62 different allied health programs. The most popular programs are physical therapy, occupational therapy, speech pathology, social work, radiology, pharmacy, health information management, sonography and respiratory therapy.

EMPLOYEES

The System employed over 43,500 full and part-time employees as of January 1, 2016, including employees of controlled joint ventured facilities. Management considers the System's relationship with its employees to be good, and there is no union representation of System employees. The System provides a competitive compensation and benefits program that includes a defined contribution retirement savings plan, life insurance, medical, dental and disability insurance plans as well as paid leave programs. The System is not immune to the growing national labor shortages and has taken aggressive steps to address potential staffing shortfalls. These steps include establishing a variety of flexible staffing solutions, actively recruiting nurses from outside the System's service area, including internationally, and instituting a more intensive employee retention program.

FOUNDATIONS

BAYLOR HEALTH CARE SYSTEM FOUNDATION

The Baylor Health Care System Foundation is a Texas nonprofit corporation, organized in 1978 to foster and support the activities and purposes of BHCS, to encourage broad-based public support of the charitable organizations affiliated with BHCS and to advance its medical objectives, including sponsorship of patient care, research, and educational and training programs.

ALL SAINTS HEALTH FOUNDATION

All Saints Health Foundation is a Texas nonprofit corporation, organized in 1983 to foster and support the activities and purposes of All Saints, to encourage broad-based public support of All Saints and to advance its medical objectives, including sponsorship of patient care, research, and educational and training programs.

IRVING HEALTHCARE FOUNDATION

Irving Healthcare Foundation is a Texas nonprofit corporation, organized in 1977 to foster and support the activities and purposes of Baylor Scott & White Medical Center – Irving and other health care charities in

Irving, Texas to encourage broad-based public support of Baylor Scott & White Medical Center – Irving in the Irving community and to advance its medical objectives, including sponsorship of patient care, research, and educational and training programs.

SCOTT & WHITE HEALTHCARE FOUNDATION

The Scott & White Healthcare Foundation is a Texas nonprofit corporation, reorganized in 2010 to foster and support the activities and purposes of S&W to encourage broad-based public support of the charitable organizations affiliated with S&W and to advance its medical objectives, including patient care, research, and educational and training programs.

SCOTT & WHITE HEALTHCARE FOUNDATION BRENHAM

Scott & White Healthcare Foundation Brenham is a Texas nonprofit corporation, organized to foster and support the activities and purposes of S&W hospital and clinical programs and facilities in the Brenham, Texas area and to encourage broad-based public support of S&W in the Brenham, Texas area and to advance its medical objectives, including patient care, research, and educational and training programs.

The following table summarizes the net assets of the System’s foundations as of the dates listed below:

| SYSTEM FOUNDATION NET ASSETS (\$ THOUSANDS) | | | |
|--|------------------------|------------------------|----------------------------|
| | As of June 30, 2014 | As of June 30, 2015 | As of December 31, 2015 |
| Unrestricted net assets | \$121,410 | \$126,015 | \$110,200 |
| Temporarily restricted net assets | 275,910 | 287,450 | 267,833 |
| Permanently restricted net assets | 226,818 | 235,684 | 240,312 |
| Total Net Assets | \$624,138 | \$649,149 | \$618,345 |

CENTRALIZED SUPPORT AND MANAGEMENT SERVICES

BSW Health provides centralized support and management services to the affiliated hospitals and other entities of the System. These services include, but are not limited to, human resources, marketing and public relations, legal, accounting, treasury, financial planning, insurance and risk management, supply chain management, tax, compliance, managed care contracting, information services, quality and health care improvement, and other related services. Additionally, the unrestricted funds of certain System entities participate in the System’s cash pool which provides for centralized management of the cash and, in some cases, investment portfolio. BSW Health charges the affiliated hospitals and other entities of the System monthly service fees to cover the corporate expenses incurred.

AFFILIATIONS

The System, through various affiliates, has affiliation agreements with the following health care facilities or hospitals: Wise Regional Health System in Decatur, Texas; Glen Rose Medical Center in Glen Rose, Texas; Hunt Regional Medical Center at Greenville and Hunt Regional Community Hospital at Commerce; and Paris Regional Medical Center. These affiliation agreements provide advisory services, physician

recruitment and access to continuing education programs and, in some cases, group purchasing organization sponsorship and catheterization lab management for a fee. The health care facilities or hospitals that are parties to these affiliation agreements are not owned or controlled by any member of the System.

Memorial Hospital owns a 32% membership interest in Metroplex Adventist Hospital, Inc. (*"Metroplex"*). The remaining membership interest in Metroplex is owned by Adventist Health System Sunbelt Healthcare Corporation. Metroplex owns and operates a hospital in Killeen, Texas and one in Lampasas, Texas. Memorial Hospital assists Metroplex in physician recruitment and various other services.

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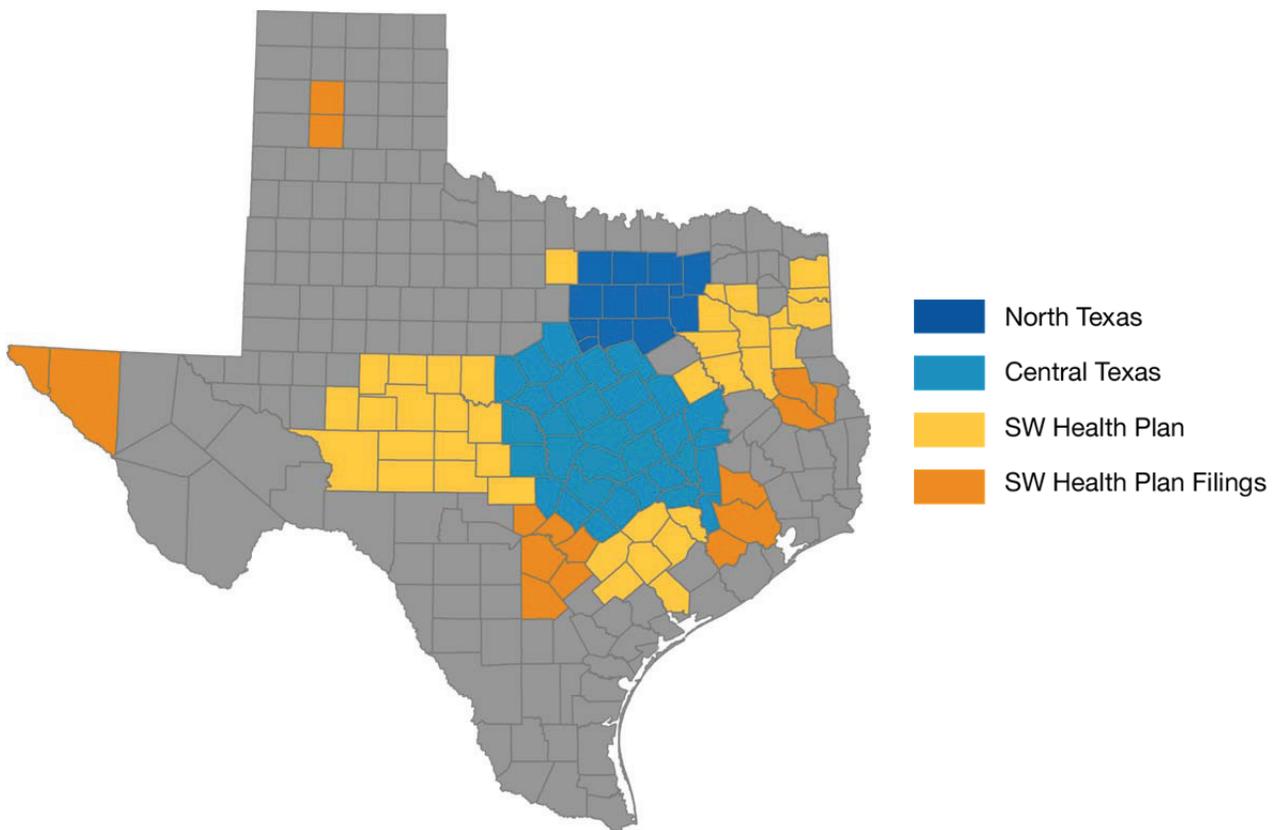
SERVICE AREA

MARKET ENVIRONMENT

The following sections contain a market overview of the State of Texas and describe the System's two current operating markets – the North Texas Area and the Central Texas Area.

The North Texas Area encompasses 13 counties, consisting of Collin, Dallas, Denton, Ellis, Hood, Hunt, Johnson, Kaufman, Parker, Rockwall, Somervell, Tarrant and Wise Counties. Dallas and Tarrant Counties accounted for 40.0% and 22.0%, respectively, of the North Texas Division's inpatient admissions in fiscal year 2015.

The Central Texas Area encompasses 32 counties in Central Texas, including Bastrop, Bell, Blanco, Bosque, Brazos, Brown, Burleson, Burnet, Caldwell, Comanche, Coryell, Erath, Falls, Grimes, Hamilton, Hays, Hill, Lampasas, Lee, Leon, Limestone, Llano, Madison, McLennan, Milam, Mills, Montgomery, Robertson, San Saba, Travis, Washington, and Williamson Counties. Two counties in the Central Texas Area, Bell and McLennan, contain Metropolitan Statistical Areas (Killeen-Temple and Waco). These two counties generated approximately 46% of the Central Texas Division's inpatient admissions for fiscal year 2015.



SERVICE AREA DEMOGRAPHICS

According to the United States Census Bureau's 2010 data, the State of Texas is the second largest state by land mass with an estimated 263,023 square miles (largest in the continental United States) and has the second largest gross domestic product of any state. Based on 2016 data from Truven Claritas data, Texas is the second most populated state in the United States with a 2016 population of 27.6 million and that population is expected to grow at a cumulative rate of 7.2% between 2016 and 2021.

The State of Texas has a diverse and growing economy. In its January 2016 *Texas Labor Market Review*, the Texas Workforce Commission reported:

- Texas employers added 24,900 net new jobs in December 2015, the ninth consecutive monthly gain in nonagricultural jobs.
- Nonagricultural employment rose 1.4% for 2015, a net gain of 166,900 new jobs across the State.
- Employment in manufacturing and in mining and logging fell by approximately 4% and 19%, respectively, in 2015, reflecting the ongoing weakness in the energy sector.
- In 2015, the Dallas-Fort Worth-Arlington MSA added 98,900 jobs, the Austin-Round Rock MSA added 34,900 jobs, and the Killeen-Temple MSA employment held steady versus 2014.
- As of December 2015, energy sector employment represented only 2.4% of State nonagricultural employment.

The following table summarizes key economic and demographic information for the State of Texas, the North Texas Area and the Central Texas Area.

| SERVICE AREA DEMOGRAPHICS | | | |
|---|------------|------------------|--------------------|
| | Texas | North Texas Area | Central Texas Area |
| Total Population ⁽¹⁾ | | | |
| 2016 | 27,611,474 | 7,118,831 | 3,407,326 |
| 2021 (estimated) | 29,594,025 | 7,668,793 | 3,681,176 |
| Expected 2016-2021 Cumulative Population Growth Rate ⁽¹⁾ | 7.2% | 7.7% | 8.0% |
| Average Household Income ⁽¹⁾ | \$77,650 | \$85,344 | \$78,565 |
| Median Age ⁽¹⁾ | 35.2 | 35.5 | 35.4 |
| Unemployment Rate ⁽²⁾ | 4.7% | 3.7% | 3.4% |

Sources:

(1) Truven Claritas, 2016

(2) Bureau of Labor Statistics, 2015

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SERVICE AREA MARKET SHARE

The following table sets forth the outpatient, inpatient, and combined market share of the System compared to other providers in the State of Texas for calendar year 2013.

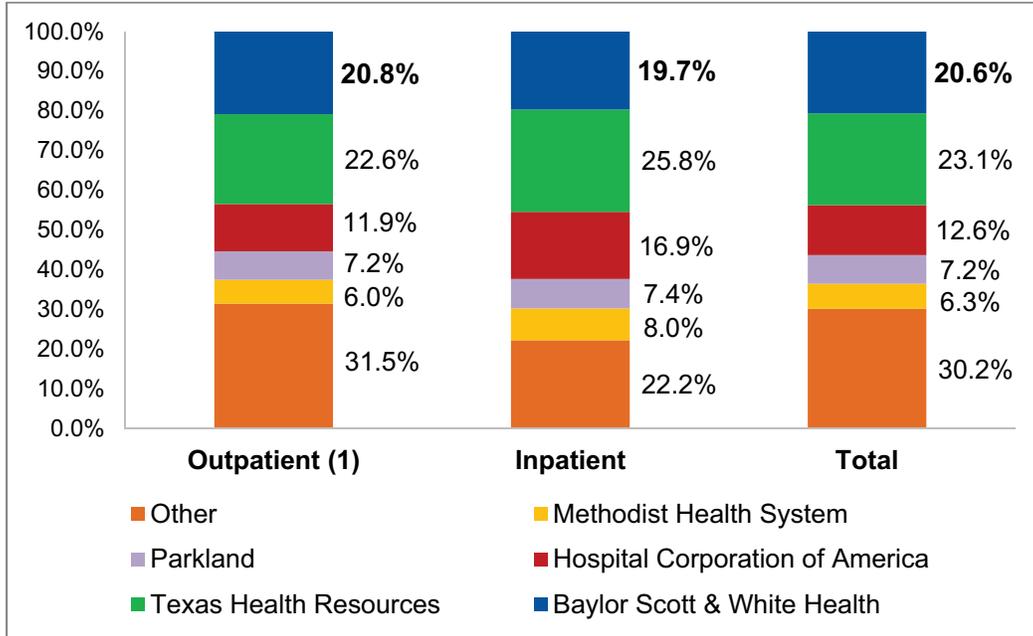
| STATE OF TEXAS OUTPATIENT, INPATIENT AND COMBINED MARKET SHARE | | | |
|---|---------------------------|-------------|-------------|
| | Outpatient ⁽¹⁾ | Inpatient | Total |
| Hospital Corporation of America | 11.1% | 17.9% | 12.2% |
| Baylor Scott & White Health | 9.6% | 7.3% | 9.2% |
| Texas Health Resources | 7.0% | 6.8% | 7.0% |
| Tenet | 4.6% | 7.3% | 5.0% |
| Memorial Hermann Health System | 4.7% | 5.9% | 4.9% |
| Ascension Health | 3.7% | 3.5% | 3.7% |
| Community Health System | 2.8% | 3.4% | 2.9% |
| Houston Methodist Hospital System | 2.4% | 3.7% | 2.6% |
| Catholic Health Initiatives | 2.4% | 3.0% | 2.5% |
| East Texas Medical Center | 2.6% | 1.5% | 2.4% |
| Others | 49.1% | 39.7% | 47.6% |
| Total | 100.0% | 100.0% | 100.0% |

(1) Includes hospital and ambulatory surgery center outpatients.
 Source: *THCIC 2013. Excluding normal newborns and psychiatry.*

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The following table sets forth the outpatient, inpatient, and combined market share of the System compared to other providers in the North Texas Area for calendar year 2013.

**NORTH TEXAS AREA
OUTPATIENT, INPATIENT AND COMBINED MARKET SHARE**

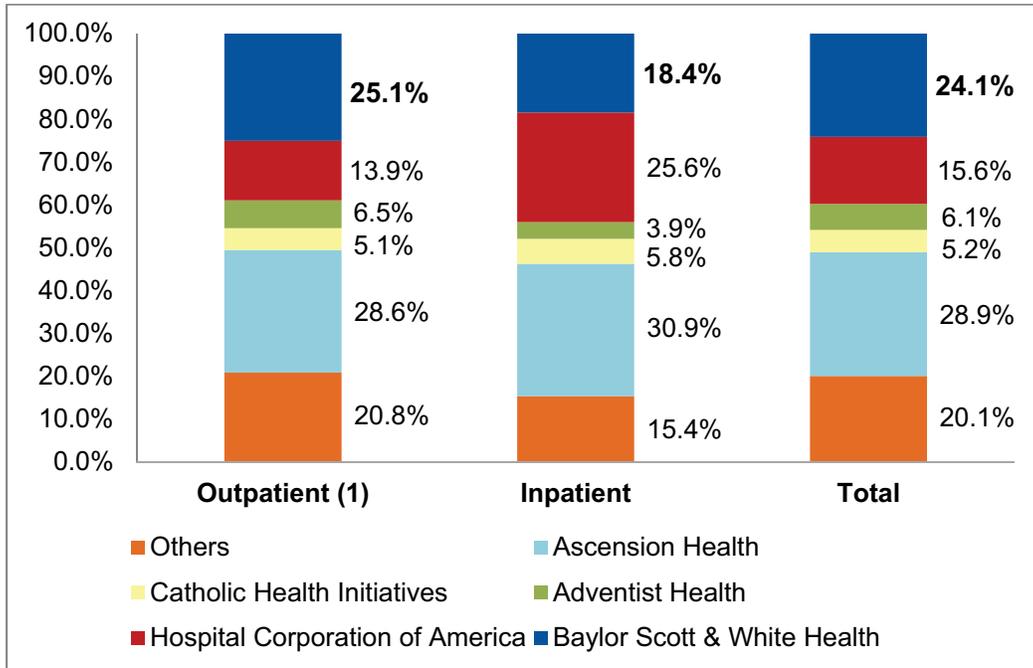


(1) Includes hospital and ambulatory surgery center outpatients.
 Source: *THCIC 2013. Excluding normal newborns and psychiatry.*

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The following table sets forth the outpatient, inpatient, and combined market share of the System compared to other providers in the Central Texas Area for calendar year 2013.

**CENTRAL TEXAS AREA
OUTPATIENT, INPATIENT AND COMBINED MARKET SHARE**



(1) Includes hospital and ambulatory surgery center outpatients.

Source: *THCIC 2013. Excluding normal newborns and psychiatry.*

STATEWIDE LICENSED BEDS

The following table sets forth the licensed beds of the major health systems in Texas.

| STATEWIDE LICENSED BEDS | | |
|--|---------------|---------------|
| Hospital Corporation of America | 10,993 | 14.0% |
| Tenet | 5,450 | 7.0% |
| Baylor Scott & White Health | 5,258 | 6.7% |
| Texas Health Resources | 4,139 | 5.3% |
| Memorial Hermann Health System | 3,601 | 4.6% |
| Community Health System | 2,812 | 3.6% |
| Houston Methodist Hospital System | 2,494 | 3.2% |
| Catholic Health Initiatives | 2,132 | 2.7% |
| Ascension Health | 2,125 | 2.7% |
| Others | 39,279 | 50.2% |
| Total | 78,283 | 100.0% |

Source: *Texas Department of Health, December 23, 2015; BSW Holdings (see "System Licensed Beds" below).*

SERVICE AREA LICENSED BEDS

The following table sets forth the licensed beds of the North Texas Division compared to its major competitors in the North Texas Area.

| NORTH TEXAS AREA LICENSED BEDS | | |
|--|--------------|--------------|
| Texas Health Resources | 4,041 | 19.9% |
| Baylor Scott & White Health | 3,629 | 17.9% |
| Hospital Corporation of America | 2,802 | 13.8% |
| Parkland | 1,838 | 9.1% |
| Methodist Health System | 1,465 | 7.2% |
| Others | 6,532 | 32.1% |
| Total | 20,307 | 100.0% |

Source: Texas Department of Health, December 23, 2015; BSW Holdings (see "System Licensed Beds" below).

The following table sets forth the licensed beds of the Central Texas Division compared to its major competitors in the Central Texas Area.

| CENTRAL TEXAS AREA LICENSED BEDS | | |
|--|--------------|--------------|
| Ascension Health | 2,125 | 28.3% |
| Baylor Scott & White Health | 1,629 | 21.7% |
| Hospital Corporation of America | 1,435 | 19.1% |
| Community Health System | 471 | 6.3% |
| Adventist Health ⁽¹⁾ | 427 | 5.7% |
| Others | 1,427 | 18.9% |
| Total | 7,514 | 100.0% |

(1) Memorial Hospital owns a 32% membership interest in Metroplex, which is part of the Adventist Health system.

Source: Texas Department of Health, December 23, 2015; BSW Holdings (see "System Licensed Beds" below).

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OPERATING INFORMATION

SYSTEM OPERATING DATA

The following table shows selected combined operating data for the hospitals and clinics of the System for the periods indicated.

| SYSTEM OPERATING DATA | | | | |
|---|-------------------------------|-----------|----------------------------------|-----------|
| | Fiscal Year Ended June 30, | | Six Months Ended December 31, | |
| | 2014 | 2015 | 2014 | 2015 |
| Inpatient Admissions ⁽¹⁾ | 184,642 | 190,617 | 94,635 | 98,509 |
| Patient Days | 957,235 | 980,009 | 483,197 | 495,502 |
| Average Length of Stay (Days) | 5.2 | 5.2 | 5.1 | 5.0 |
| Emergency Room Visits | 638,985 | 716,404 | 355,761 | 365,431 |
| Outpatient Registrations | 3,200,982 | 3,227,365 | 1,610,876 | 1,732,431 |
| Clinic Visits (IP & OP) | 2,690,162 | 2,844,041 | 1,373,971 | 1,447,880 |
| HealthTexas Encounters | 2,032,067 | 2,206,694 | 1,063,129 | 1,175,689 |
| Gross Outpatient Revenue as a Percent of Total Gross Patient Revenues | 57.7% | 59.3% | 58.6% | 60.3% |

(1) Admissions include adult and special care nursery.

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SYSTEM LICENSED BEDS

| SYSTEM LICENSED BEDS | | |
|---|-------------------------|------------------------------|
| Name of Hospital | Location | Licensed Beds ⁽¹⁾ |
| Baylor University Medical Center | Dallas, Texas | 1,010 |
| Scott & White Memorial Hospital | Temple, Texas | 614 |
| Baylor Scott & White Medical Center – Hillcrest | Waco, Texas | 576 |
| Baylor Scott & White All Saints Medical Center – Fort Worth | Fort Worth, Texas | 574 |
| Baylor Scott & White Medical Center – Grapevine | Grapevine, Texas | 313 |
| Baylor Scott & White Medical Center – Plano | Plano, Texas | 160 |
| Baylor Scott & White Medical Center – McKinney ⁽²⁾ | McKinney, Texas | 143 |
| Scott & White Hospital – College Station ⁽²⁾ | College Station, Texas | 119 |
| Baylor Scott & White Medical Center – Waxahachie | Waxahachie, Texas | 104 |
| Baylor Scott & White Medical Center – Round Rock | Round Rock, Texas | 101 |
| Baylor Scott & White Continuing Care Hospital | Temple, Texas | 50 |
| Subtotal Obligated Group | | 3,764 |
| Baylor Scott & White Medical Center – Irving | Irving, Texas | 293 |
| Texas Health Ventures Group (8 hospitals) | Throughout Service Area | 228 |
| BIR JV, LLP (4 hospitals) ⁽³⁾ | Throughout Service Area | 220 |
| Baylor Scott & White Medical Center – Carrollton | Carrollton, Texas | 216 |
| The Heart Hospital Baylor Plano | Plano, Texas | 116 |
| Baylor Scott & White Medical Center – Garland | Garland, Texas | 113 |
| Baylor Jack and Jane Hamilton Heart and Vascular Hospital | Dallas, Texas | 61 |
| Baylor Scott & White Medical Center – Brenham | Brenham, Texas | 60 |
| EBD, JV, LLP (7 emergency centers) | Throughout Service Area | 56 |
| Baylor Scott & White Medical Center – Marble Falls | Marble Falls, Texas | 46 |
| Baylor Scott & White Medical Center – Llano | Llano, Texas | 30 |
| Baylor Scott & White Medical Center – Taylor | Taylor, Texas | 25 |
| The Heart Hospital Baylor Denton | Denton, Texas | 22 |
| ESWCT, LLC (1 emergency center) | Cedar Park, Texas | 8 |
| Subtotal Other System Hospitals | | 1,494 |
| Total System Hospitals | | 5,258 |

(1) As of December 23, 2015 for entities that BSW Holdings owns or controls at least 50%.

(2) It is anticipated that effective on the closing date of the Series 2016A Bonds, McKinney and College Station will be added as Obligated Affiliates under the Master Indenture.

(3) It is expected that Baylor Institute for Rehabilitation at Northwest Dallas, which has 42 licensed beds, will wind up operations in mid-May 2016 and close June 1, 2016.

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FINANCIAL INFORMATION

SUMMARY COMBINED FINANCIAL INFORMATION

The following tables set forth certain select summary combined financial information with respect to BSW Holdings and its controlled affiliates. The summary proforma combined financial information for the fiscal year ended June 30, 2014 is unaudited and presents the combined financial information of BSW Holdings as if the merger of BHCS and S&W had occurred on July 1, 2013. The proforma combined financial information has been adjusted to conform the individual accounting policies of BHCS and S&W in those time periods prior to the merger. The unaudited proforma combined financial information is provided for informational purposes only. The unaudited proforma combined financial information is not necessarily, and should not be assumed to be, an indication of the results that would have been achieved had the merger been completed as of the date indicated or that may be achieved in the future. The preparation of the unaudited proforma combined financial information and related adjustments required management to make certain assumptions and estimates. The summary combined financial information for the fiscal year ended June 30, 2015 is derived from the audited combined financial statements of the System. The unaudited combined financial information for the six months ended December 31, 2015 and 2014 is derived from unaudited interim financial statements of the System and includes all adjustments which the System considers necessary for a fair statement of the financial position and the results of operations for these time periods. The summary proforma combined financial information for the fiscal year ended June 30, 2014 and the summary combined financial information for fiscal year ended June 30, 2015 should be read in conjunction with the complete audited combined financial statements of the System for the year ended June 30, 2015 and the nine months ended June 30, 2014 set forth in APPENDIX B-1. The summary combined financial information for the six months ended December 31, 2015 and 2014 should be read in conjunction with the unaudited interim combined financial statements of the System for the six months ended December 31, 2015 and 2014 set forth in APPENDIX B-2.

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SELECTED SYSTEM FINANCIAL INFORMATION
(\$ THOUSANDS)

| | Proforma | | Actual | |
|---|------------------------------------|-------------------|----------------------------------|--------------|
| | Fiscal Year ended June 30, | | Six Months ended December 31, | |
| | (Unaudited) 2014 ⁽¹⁾ | (Audited) 2015 | (Unaudited) | |
| | | | 2014 | 2015 |
| Results of Operations/Changes in Net Assets | | | | |
| Net patient care revenue, net of patient related bad debt expense | \$ 5,690,973 | \$ 6,394,126 | \$ 3,133,167 | \$ 3,480,734 |
| Total operating revenue | 6,745,162 | 7,535,926 | 3,655,122 | 4,040,653 |
| Total operating expenses before depreciation and amortization | 6,072,543 | 6,519,859 | 3,161,634 | 3,472,783 |
| Depreciation and amortization | 356,460 | 343,736 | 168,785 | 177,881 |
| Interest expense | 88,324 | 93,563 | 45,555 | 48,761 |
| Income from operations | 316,159 | 672,331 | 324,703 | 389,989 |
| Net gains (losses) on trading investments | 336,406 | 56,772 | (17,750) | (104,206) |
| Net losses on interest rate swaps | (34,917) | (69,244) | (78,962) | (49,231) |
| Total nonoperating gains (losses) | 296,532 | (84,409) | (101,310) | (156,125) |
| Revenue and gains in excess of expenses and losses (before taxes) | 612,691 | 587,922 | 223,393 | 233,864 |
| Revenue and gains in excess of expenses and losses | 601,760 | 579,547 | 218,081 | 226,909 |
| Cash Flow & Financial Ratios | | | | |
| Adjusted operating cash flow ⁽²⁾ | 760,943 | 1,109,630 | 539,043 | 616,631 |
| Adjusted EBITDA ⁽³⁾ | 908,802 | 1,301,723 | 590,514 | 643,243 |
| Income from operations as a percentage of total operating revenue | 4.7% | 8.9% | 8.9% | 9.7% |
| Operating cash flow as a percentage of total revenue ⁽²⁾ | 11.3% | 14.7% | 14.7% | 15.3% |

(1) Proforma fiscal year 2014 is based on System audited financial statements for the nine months ended June 30, 2014 and unaudited historical interim financial information for both BHCS and S&W for the three months ended September 30, 2013. See "Proforma Combined Statement of Operations and Changes in Net Assets for Twelve Months Ended June 30, 2014" below.

(2) Adjusted operating cash flow is defined as income from operations plus depreciation and amortization plus interest expense. Adjusted operating cash flow as a percentage of total revenue is calculated by dividing the operating cash flow by total operating revenue.

(3) Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") has been modified to exclude unrealized gains/losses on investments, unrealized gains/losses on interest rate swaps, and loss on extinguishment of debt.

COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
(\$ THOUSANDS)

| | Proforma | Actual | Actual | |
|--|------------------------------------|-------------------|----------------------------------|--------------|
| | Fiscal Year ended June 30, | | Six Months ended December 31, | |
| | (Unaudited) 2014 ⁽¹⁾ | (Audited) 2015 | (Unaudited) | |
| | | | 2014 | 2015 |
| Operating Revenue: | | | | |
| Net patient care revenue | \$ 5,690,973 | \$ 6,394,126 | \$ 3,133,167 | \$ 3,480,734 |
| Other operating revenue and premium revenue | 983,502 | 1,072,589 | 490,363 | 531,927 |
| Net assets released from restrictions for operations | 70,687 | 69,211 | 31,592 | 27,992 |
| Total operating revenue | 6,745,162 | 7,535,926 | 3,655,122 | 4,040,653 |
| Operating Expenses: | | | | |
| Salaries, wages and employee benefits | 3,308,950 | 3,538,933 | 1,721,828 | 1,890,281 |
| Supplies and other operating expenses | 2,441,421 | 2,617,330 | 1,274,869 | 1,422,853 |
| Medical claims | 225,308 | 270,873 | 119,885 | 115,037 |
| Losses (gains) on fixed asset disposals, net | 8,540 | (840) | (503) | (4,149) |
| Depreciation and amortization | 356,460 | 343,736 | 168,785 | 177,881 |
| Interest | 88,324 | 93,563 | 45,555 | 48,761 |
| Total operating expenses | 6,429,003 | 6,863,595 | 3,330,419 | 3,650,664 |
| Income from operations | 316,159 | 672,331 | 324,703 | 389,989 |
| Nonoperating Expenses: | | | | |
| Gains (losses) on investments, net | 336,406 | 56,772 | (17,750) | (104,206) |
| Interest rate swap activity | (34,917) | (69,244) | (78,962) | (49,231) |
| Other nonoperating losses (inc. taxes) | (15,888) | (80,312) | (9,910) | (9,643) |
| Total nonoperating expenses | 285,601 | (92,784) | (106,622) | (163,080) |
| Revenue and Gains in Excess of Expenses and Losses | | | | |
| Other changes in unrestricted net assets | 601,760 | 579,547 | 218,081 | 226,909 |
| Changes in temporarily and permanently restricted net assets | (141,563) | (235,708) | (128,510) | (128,807) |
| | 28,142 | 12,530 | (4,327) | (14,995) |
| Increase in Net Assets | \$ 488,339 | \$ 356,369 | \$ 85,244 | \$ 83,107 |

(1) Proforma fiscal year 2014 is based on System audited financial statements for the nine months ended June 30, 2014 and unaudited historical interim financial information for both BHCS and S&W for the three months ended September 30, 2013. See "Proforma Combined Statement of Operations and Changes in Net Assets for Twelve Months Ended June 30, 2014" below.

COMBINED BALANCE SHEETS
(\$ THOUSANDS)

| | As of June 30, (Audited) | | As of December 31, (Unaudited) |
|---|--------------------------------|---------------------|--------------------------------------|
| | 2014 | 2015 | 2015 |
| Assets | | | |
| Cash and cash equivalents and short-term investments | \$ 816,394 | \$ 1,257,157 | \$ 1,033,137 |
| Patient accounts receivable, net | 611,386 | 637,637 | 693,642 |
| Other current assets | 686,241 | 542,010 | 976,263 |
| Unrestricted investments | 2,261,958 | 2,642,204 | 2,639,295 |
| Restricted investments and assets whose use is limited | 740,269 | 659,969 | 642,773 |
| Property and equipment, net | 3,319,123 | 3,371,810 | 3,348,622 |
| Other long-term assets | 534,007 | 576,630 | 584,795 |
| Total assets | \$ 8,969,378 | \$ 9,687,417 | \$ 9,918,527 |
| Liabilities and Net Assets | | | |
| Current maturities of long-term debt and capital lease obligations | \$ 138,322 | \$ 61,464 | \$ 88,946 |
| Long-term debt subject to remarketing arrangements | 95,000 | 95,000 | 95,000 |
| Other current liabilities | 1,040,218 | 1,017,680 | 906,275 |
| Long-term debt and capital lease obligations, less current maturities | 2,302,187 | 2,642,677 | 2,781,806 |
| Other long-term liabilities | 469,223 | 557,954 | 630,517 |
| Noncontrolling interests - redeemable | 281,160 | 313,005 | 333,239 |
| Total unrestricted net assets | 4,123,855 | 4,467,694 | 4,565,796 |
| Temporarily and permanently restricted net assets | 519,413 | 531,943 | 516,948 |
| Total liabilities and net assets | \$ 8,969,378 | \$ 9,687,417 | \$ 9,918,527 |

The following table sets forth the proforma combined statement of operations and changes in net assets for BSW Holdings and its controlled affiliates for the twelve months ended June 30, 2014 as if the merger of BHCS and S&W had occurred on July 1, 2013. This financial information is provided for informational purposes only and is not necessarily, and should not be assumed to be, an indication of the results that would have been achieved had the merger been completed as of the date indicated or that may be achieved in the future. This information has been adjusted to conform the individual accounting policies of BHCS and S&W in the time period prior to the merger as shown below, and required management to make certain assumptions and estimates. This table should be read in conjunction with the complete audited combined financial statements of the System for the nine months ended June 30, 2014 set forth in APPENDIX B-1.

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**PROFORMA COMBINED STATEMENT OF OPERATIONS AND
CHANGES IN NET ASSETS FOR TWELVE MONTHS ENDED JUNE 30, 2014
(\$ THOUSANDS)**

| | 9 months ended June 2014 System (Audited) | Jul-Sept 2013 BHCS (Unaudited) | Jul-Sept 2013 S&W (Unaudited) | Proforma Adjustments BHCS+S&W | Description of Adjustments | Proforma June 2014 System |
|--|---|--------------------------------------|-------------------------------------|-------------------------------------|----------------------------------|---------------------------------|
| OPERATING REVENUE | | | | | | |
| Net patient care revenue | \$ 4,325,133 | \$ 1,031,189 | \$ 334,651 | \$ – | | \$ 5,690,973 |
| Other operating revenue and premium revenue | 744,672 | 42,492 | 195,696 | 642 | A | 983,502 |
| Net assets released from restrictions for operations | 53,187 | 14,510 | 513 | 2,477 | B | 70,687 |
| Total operating revenue | 5,122,992 | 1,088,191 | 530,860 | 3,119 | | 6,745,162 |
| OPERATING EXPENSES | | | | | | |
| Salaries, wages and employee benefits | 2,491,396 | 502,379 | 305,367 | 9,808 | A,B,G | 3,308,950 |
| Supplies and other operating expenses | 1,844,597 | 407,575 | 181,614 | 7,635 | A,B,C,F,G | 2,441,421 |
| Medical claims | 176,967 | – | 48,341 | – | | 225,308 |
| Losses on fixed asset disposals, net | 346 | – | 7,849 | 345 | E | 8,540 |
| Depreciation and amortization | 265,634 | 60,397 | 29,101 | 1,328 | A,G | 356,460 |
| Interest | 66,654 | 15,050 | 6,579 | 41 | A,D,G | 88,324 |
| Total operating expenses | 4,845,594 | 985,401 | 578,851 | 19,157 | | 6,429,003 |
| Income from operations | 277,398 | 102,790 | (47,991) | (16,038) | | 316,159 |
| NONOPERATING GAINS (LOSSES) | | | | | | |
| Gains on investments, net | 232,215 | 81,091 | 21,806 | 1,294 | C,H | 336,406 |
| Interest rate swap activity | (50,134) | 6,975 | 8,316 | (74) | D | (34,917) |
| Other nonoperating gains (losses) (inc. taxes) | (11,879) | (3,776) | (16,630) | 16,397 | A,C,E,F,G, H, I | (15,888) |
| Total nonoperating gains | 170,202 | 84,290 | 13,492 | 17,617 | | 285,601 |
| REVENUE AND GAINS (LOSSES) IN EXCESS (DEFICIT) OF EXPENSES AND LOSSES | | | | | | |
| | 447,600 | 187,080 | (34,499) | 1,579 | | 601,760 |
| Other changes in unrestricted net assets | (121,239) | (28,355) | 8,036 | (5) | B | (141,563) |
| Changes in temporarily and permanently restricted net assets | 16,690 | 9,173 | 3,853 | (1,574) | I | 28,142 |
| INCREASE (DECREASE) IN NET ASSETS | \$ 343,051 | \$ 167,898 | \$ (22,610) | \$ – | | \$ 488,339 |

[Footnotes to table on following page.]

Footnotes to "Proforma Combined Statement of Operations and Changes in Net Assets for Twelve Months Ended June 30, 2014" table:

- A To reclassify the net activity of Scott & White Properties from non-operating gains and losses to operating revenue and operating expenses.
- B To reclassify temporarily restricted research and education activities from a net presentation in changes in temporarily restricted net assets to net assets released from operations in operating revenue.
- C To reclassify the net activity of Scott & White Assurance Ltd. from non-operating gains and losses to operating revenue and operating expenses.
- D To reclassify interest rate swap payments from interest expense to interest rate swap activity.
- E To reclassify gains and losses on fixed assets disposals from non-operating gains and losses to operating expenses.
- F To reclassify the overhead expenses of Scott & White Development Foundation from non-operating gains and losses to operating expenses.
- G To reclassify unrestricted research and education activities from non-operating gains and losses to operating expenses.
- H To reclassify bank fees, royalty income and investment income from other non-operating gains and losses to gains on investments, net.
- I To reclassify bad debt expense on temporarily restricted pledges from non-operating gains and losses to temporarily restricted net assets.

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MANAGEMENT DISCUSSION OF RECENT FINANCIAL PERFORMANCE

OVERVIEW

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of BSW Holdings and its affiliates combined results of operations and financial condition. References to certain financial results of BSW Holdings include the results of its controlled affiliates. This discussion should be read in conjunction with the combined financial statements and accompanying notes. See APPENDIX B-1 and APPENDIX B-2.

SIX MONTH PERIOD ENDED DECEMBER 31, 2015 COMPARED TO SIX MONTH PERIOD ENDED DECEMBER 31, 2014

Income from operations for the first six months of fiscal year 2016 was \$390.0 million (9.7% of total operating revenue), compared to \$324.7 million (8.9% of total operating revenue) for the first six months of fiscal year 2015. Adjusted EBITDA for the six months ended December 31, 2015 was \$643.2 million (15.9% of total operating revenue) versus \$590.5 million (16.2% of total operating revenue) for the six months ended December 31, 2014.

The total combined year-to-date operating revenue increased \$385.6 million or 10.5% to \$4,040.7 million in the first six months of fiscal year 2016 compared to \$3,655.1 million over the same period of fiscal year 2015.

Net patient care revenue, net of patient related bad debt expense, increased \$347.5 million or 11.1% to \$3,480.7 million in the first six months of fiscal year 2016 compared to \$3,133.2 million in the first six months of fiscal year 2015. The increase in net patient revenue primarily reflects higher patient volumes.

Net assets released from restrictions for operations decreased \$3.6 million or -11.4% to \$28.0 million in the first six months of fiscal year 2016 compared to \$31.6 million in the same period in fiscal year 2015.

Combined operating expenses for the first six months of fiscal year 2016 were \$3,650.7 million, an increase of \$320.3 million or 9.6% over the first six months of fiscal year 2015. The increase is largely attributable to salaries, supplies and other operating expenses described in further detail below.

Salaries, wages, and employee benefits increased \$168.5 million or 9.8% to \$1,890.3 million for the first six months in fiscal year 2016 compared to \$1,721.8 million for the first six months in fiscal year 2015. Salaries, wages, and employee benefits as a percentage of total operating revenue increased from 47.1% for the first six months of fiscal year 2015 to 46.8% for the same period in 2016. Salaries, wages, and employee benefits represented approximately 51.8% and 51.7% of total operating expenses for the first six months of fiscal years 2016 and 2015, respectively.

Supplies and other operating expenses increased \$148.0 million or 11.6% for the first six months of fiscal year 2016 to \$1,422.9 million compared to \$1,274.9 million for the first six months in fiscal year 2015, and represented approximately 35.2% and 34.9% of total operating revenue for the first six months of fiscal years 2016 and 2015, respectively. Supplies and other operating expenses represented approximately 39.0% and 38.3% of total operating expenses for the first six months of fiscal years 2016 and 2015, respectively.

Depreciation and amortization increased \$9.1 million or 5.4% to \$177.9 million for the first six months in fiscal year 2016 compared to \$168.8 million for the first six months in fiscal year 2015.

Interest expense increased \$3.2 million or 7.0% to \$48.8 million for the first six months in fiscal year 2016 compared to \$45.6 million for the first six months in fiscal year 2015.

The System recorded unrestricted unrealized losses on investments of \$140.1 million for the first six months of fiscal year 2016, compared to unrestricted unrealized losses of \$74.2 million for the same period in fiscal year 2015. Unrestricted realized gains and investment income on investments were \$34.2 million for the first six months of fiscal year 2016 compared to unrestricted realized gains and investment income on investments of \$61.6 million for the same period in fiscal year 2015, representing a decrease of \$27.4 million or -44.5% over the same period in fiscal year 2015. The System recorded unrealized losses for the interest rate swap portfolio of \$42.5 million for the first six months of fiscal year 2016, compared to \$72.2 million for the same period in fiscal year 2015.

Unrestricted cash and investments of \$3.7 billion at December 31, 2015 decreased \$227.0 million as compared to unrestricted cash and investments of \$3.9 billion at June 30, 2015 after capital expenditures of \$163.9 million and net losses on trading investments of \$104.2 million. Unrestricted days cash on hand decreased to 194.6 days at December 31, 2015 from 218.3 days at June 30, 2015. Including restricted funds, days cash on hand totaled 228.6 days at December 31, 2015, compared to 255.2 days at June 30, 2015. The debt to capitalization ratio increased to 38.7% at December 31, 2015 from 38.0% at June 30, 2015, and total assets increased 2.4% to \$9,918.5 million at December 31, 2015 from June 30, 2015.

ACTUAL FISCAL YEAR 2015 COMPARED TO PROFORMA FISCAL YEAR 2014

Unrestricted cash and investments of \$3.9 billion at June 30, 2015 increased \$821.0 million as compared to unrestricted cash and investments of \$3.1 billion at June 30, 2014 after capital expenditures of \$426.1 million and net gains on trading investments of \$56.8 million. Unrestricted days cash on hand increased to 218.3 days at June 30, 2015 compared to 185.0 days at June 30, 2014. Including restricted funds, days cash on hand totaled 255.2 days at June 30, 2015, compared to 229.5 days at June 30, 2014. The debt to capitalization ratio increased to 38.0% at June 30, 2015 from 36.8% at June 30, 2014, and total assets increased 8.0% to \$9,687.4 million at June 30, 2015 from June 30, 2014.

Income from operations for fiscal year 2015 was \$672.3 million (8.9% of total operating revenue), compared to \$316.2 million (4.7% of total operating revenue) for fiscal year 2014. For fiscal year 2015, adjusted EBITDA was \$1,301.7 million (17.3% of total operating revenue) versus \$908.8 million (13.5% of total operating revenue) for fiscal year 2014.

The total combined operating revenue increased \$790.7 million or 11.7% to \$7,535.9 million for fiscal year 2015 compared to \$6,745.2 million for fiscal year 2014.

Net patient care revenue, net of patient related bad debt expense, increased \$703.1 million or 12.4% to \$6,394.1 million for fiscal year 2015 compared to \$5,691.0 million for fiscal year 2014. The increase in net patient revenue primarily reflects higher patient volumes.

Combined operating expenses for fiscal year 2015 were \$6,863.6 million, an increase of \$434.6 million or 6.8% over fiscal year 2014.

Salaries, wages, and employee benefits increased \$229.9 million or 6.9% to \$3,538.9 million in fiscal year 2015 compared to \$3,309.0 million in fiscal year 2014, representing approximately 47.0% and 49.1% of total operating revenue for fiscal years 2015 and 2014, respectively. Salaries, wages, and employee benefits represented approximately 51.6% and 51.5% of total operating expenses for fiscal years 2015 and 2014, respectively.

Supplies and other operating expenses increased \$175.9 million or 7.2% for fiscal year 2015 to \$2,617.3 million compared to \$2,441.4 million for fiscal year 2014 and represented approximately 34.7% and 36.2% of total operating revenue in fiscal years 2015 and 2014, respectively. Supplies and other operating expenses represented approximately 38.1% and 38.0% of total operating expenses for fiscal years 2015 and 2014, respectively.

Depreciation and amortization decreased \$12.8 million or -3.6% to \$343.7 million for fiscal year 2015 compared to \$356.5 million for fiscal year 2014.

Interest expense increased \$5.3 million or 6.0% to \$93.6 million for fiscal year 2015 compared to \$88.3 million for fiscal year 2014.

The System recorded unrestricted unrealized losses on investments of \$144.7 million for fiscal year 2015, compared to unrestricted unrealized gains of \$170.7 million for the same period in fiscal year 2014. Unrestricted realized gains and investment income on investments were \$206.7 million for fiscal year 2015 compared to unrestricted realized gains and investment income on investments of \$165.7 million in fiscal year 2014, an increase of \$41.0 million or 24.7%. The System recorded unrealized losses for the interest rate swap portfolio of \$55.2 million for fiscal year 2015, compared to \$21.7 million in fiscal year 2014.

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PAYOR MIX BY GROSS REVENUE

The System derives its patient revenue from Medicare, Medicaid, managed care companies, commercial insurers, self-paying patients and other sources. Set forth below is a table showing the source of payment of gross patient revenue from combined hospital and clinic operations of the System for each of the respective periods indicated, excluding HealthTexas, THVG, BIR JV, EBD JV, and ESWCT Cedar Park, LLC.

| PAYOR MIX BY GROSS REVENUE | | | | |
|--|-------------------------------|--------|----------------------------------|-------|
| | Proforma | Actual | Actual | |
| | Fiscal Year ended June 30, | | Six Months ended December 31, | |
| | 2014 ⁽¹⁾ | 2015 | 2014 | 2015 |
| Medicare | 40.4% | 42.5% | 42.1% | 40.5% |
| Medicaid (including Medicaid managed care) | 9.6% | 9.4% | 9.5% | 8.8% |
| Managed care/commercial insurance ⁽²⁾ | 38.5% | 38.2% | 38.6% | 39.8% |
| Self-Pay | 11.2% | 8.4% | 8.5% | 9.1% |
| Health Insurance Exchange | 0.3% | 1.5% | 1.3% | 1.8% |
| Total | 100% | 100% | 100% | 100% |

(1) Proforma fiscal year 2014 covers the periods included in and is based on System audited financial statements for the nine months ended June 30, 2014 and unaudited historical interim financial information for both BHCS and S&W for the three months ended September 30, 2013.

(2) Includes managed care, Blue Cross, CHAMPUS, workers compensation, and other government contracts.

COMMUNITY BENEFIT

The System is committed to offering access to quality health care, including providing free or discounted health care to the indigent and underserved population through its affiliated health care providers. As part of its charitable mission, the System's nonprofit hospitals provided community benefits (as reported to the Texas Department of State Health Services) in excess of \$743 million in fiscal year 2015. This amount includes the unreimbursed cost of charity care, Medicaid and Medicare and other community benefits.

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DEBT SERVICE COVERAGE

The following table sets forth, for the proforma fiscal year ended June 30, 2014 and the fiscal year ended June 30, 2015, the consolidated net revenues of the System available to pay debt service on the Master Debt and all other long-term debt of the System, and the extent to which such consolidated net revenues would provide coverage for the maximum annual debt service on the Master Debt and other long-term debt of the System both prior to and after application of the proceeds of the Series 2016A Bonds and the Taxable Bonds during such periods. The maximum annual debt service requirements in the following table are calculated in accordance with the Master Indenture.

| SYSTEM CONSOLIDATED DEBT SERVICE COVERAGE (\$ THOUSANDS) | | |
|---|---------------------|--------------|
| | Proforma | Actual |
| | Fiscal year ended | |
| | June 30, | |
| | 2014 ⁽¹⁾ | 2015 |
| Excess of revenues over expenses | \$ 601,760 | \$ 579,547 |
| Depreciation and amortization | 356,460 | 343,736 |
| Interest expense | 88,324 | 93,563 |
| Loss from extinguishment of debt | 293 | 71,379 |
| Unrealized (gains)/losses on investments | (170,690) | 149,904 |
| Unrealized (gains)/losses on interest rate swaps | 21,724 | 55,219 |
| Consolidated net revenues available for debt service | \$ 897,871 | \$ 1,293,348 |
| Estimated maximum annual debt service on the outstanding consolidated debt prior to the issuance of the Series 2016A Bonds ⁽²⁾ | \$ 158,632 | \$ 158,632 |
| Historical coverage of estimated maximum annual debt service on the outstanding consolidated debt prior to the issuance of the Series 2016A Bonds | 5.66x | 8.15x |
| Estimated proforma maximum annual debt service on the Series 2016A Bonds and other outstanding consolidated debt | \$ 191,070 | \$ 191,070 |
| Historical coverage of estimated proforma maximum annual debt service on the Series 2016A Bonds and other outstanding consolidated debt | 4.70x | 6.77x |

(1) Proforma fiscal year 2014 is based on System audited financial statements for the nine months ended June 30, 2014 and unaudited historical interim financial information for both BHCS and S&W for the three months ended September 30, 2013. See "Proforma Combined Statement of Operations and Changes in Net Assets for Twelve Months Ended June 30, 2014" above.

(2) Estimated maximum annual debt service for any future fiscal year ending after 2015 without taking into account the issuance of the Series 2016A Bonds, the issuance of the Taxable Bonds, and the defeasance of the Series 2010 Bonds with the proceeds of the Series 2016A Bonds. Debt service requirements have been calculated using the assumptions noted in the Official Statement under "PRO FORMA AGGREGATE ANNUAL DEBT SERVICE REQUIREMENTS."

CAPITAL LEASES

The System entities are parties to a number of capital leases that relate to System facilities. The System's capital lease obligations constitute a substantial portion of its debt. See "– Debt and Capitalization" below. The table below sets forth the principal amount owed by the System under its capital leases as of June 30, 2014 and June 30, 2015, together with a description of the interest rate and payment terms of certain capital leases.

| CAPITAL LEASES (\$ THOUSANDS) | | |
|--|--------------------------------|--------------------------------|
| Leases | As of June 30, 2014 | As of June 30, 2015 |
| Baylor Medical Center at Irving - Capital Building Lease Interest of 3.68%, payable monthly, principal and interest payments through March 2045 | \$ 162,457 | \$ 159,523 |
| Baylor Medical Center at Carrollton - Building Lease Interest of 9.50%, payable monthly, principal and interest payments through December 2033 | 58,503 | 57,405 |
| BHCS Building Lease - Crutcher Annex Interest of 2.85%, payable monthly, principal and interest payments through May 2025 | 12,674 | 11,793 |
| HRT Properties of Texas, LTD. - Building Leases Interest of 4.88%, payable monthly, principal and interest payments through September 2017 | 9,341 | 6,652 |
| Texas Heart Hospital of the Southwest, LLP – Denton Building Lease Interest of 5.50%, payable monthly, principal and interest payments through 2030 | 25,000 | 25,000 |
| THVG Capital Lease - Frisco Medical Center, LLP - Building Lease Interest of 11.63%, payable monthly, principal and interest payments through June 2027 | 60,381 | 59,196 |
| THVG Capital Lease - Arlington Ortho - Building Lease Interest of 8.61%, payable monthly, principal and interest payments through January 2030 | 22,776 | 22,335 |
| THVG Capital Lease - Dallas Uptown - Building Lease Interest of 9.43%, payable monthly, principal and interest payments through January 2031 | 23,154 | 22,859 |
| THVG Capital Lease - Lewisville Surgicare - Building Lease Interest of 11.39%, payable monthly, principal and interest payments through December 2022 | 4,705 | 4,375 |
| THVG Capital Lease - Grapevine Surgicare Partners - Building Lease Interest of 12.66%, payable monthly, principal and interest payments through October 2021 | 3,623 | 3,337 |
| Other System Capital Leases | 33,501 | 27,781 |
| Total | \$ 416,115 | \$ 400,256 |

DEBT AND CAPITALIZATION

The table below provides the actual outstanding debt of the System as of June 30, 2014, June 30, 2015 and December 31, 2015, and the outstanding debt of the System as of December 31, 2015 adjusted to reflect the issuance of the Series 2016A Bonds (the “BSWH Series 2016A Bonds” below) and the Taxable Bonds (the “BSWH Taxable Bonds Series 2016” below) and the application of the proceeds of the Series 2016A Bonds and the Taxable Bonds to the defeasance of other outstanding debt.

| SYSTEM DEBT AND CAPITALIZATION (IN THOUSANDS) | | | | |
|--|---------------------|---------------------|---------------------|---------------------|
| | Actual | | Actual | Proforma |
| | As of June 30, | | As of December 31, | |
| | 2014 | 2015 | 2015 | 2015 |
| Long-Term Debt – Fixed Rate: ⁽¹⁾ | | | | |
| S&W Series 2008A Bonds | \$ 148,770 | \$ – | \$ – | \$ – |
| BHCS Series 2009 Bonds | 205,290 | – | – | – |
| S&W Series 2010 Bonds | 339,215 | 270,835 | 267,305 | – |
| BHCS Series 2011A Bonds | 95,670 | 79,370 | 62,010 | 62,010 |
| BHCS Series 2013A Bonds | 168,565 | 168,565 | 168,565 | 168,565 |
| S&W Series 2013A Bonds | 176,690 | 176,690 | 174,900 | 174,900 |
| BHCS Series 2013C Bonds | 63,045 | 63,045 | 63,045 | 63,045 |
| BSWH Series 2015A Bonds ⁽²⁾ | – | 176,960 | 175,615 | 175,615 |
| BSWH Taxable Bonds Series 2015 | – | 549,935 | 549,935 | 549,935 |
| BSWH Series 2016A Bonds | – | – | – | 373,340 |
| BSWH Taxable Bonds Series 2016 | – | – | – | 534,785 |
| Fixed Rate Debt | 1,197,245 | 1,485,400 | 1,461,375 | 2,102,195 |
| Long-Term Debt – Variable Rate: ⁽³⁾ | | | | |
| BHCS Series 2000 Notes ⁽⁴⁾ | 19,700 | 19,700 | 19,700 | 19,700 |
| S&W Series 2008A-1 Bonds | 85,775 | 85,775 | – | – |
| BHCS Series 2011B Bonds ⁽⁵⁾ | 50,000 | 50,000 | 50,000 | 50,000 |
| BHCS Series 2011C, D, and E Bonds ⁽⁶⁾ | 135,355 | 134,180 | 45,120 | 45,120 |
| BHCS Series 2011F and G Bonds ⁽⁷⁾⁽⁸⁾⁽⁹⁾ | 75,000 | 75,000 | 75,000 | 75,000 |
| BHCS Series 2013B Bonds ⁽⁵⁾ | 45,000 | 45,000 | 45,000 | 45,000 |
| S&W Series 2013B Bonds ⁽⁹⁾⁽¹⁰⁾ | 81,680 | 80,495 | 79,305 | 79,305 |
| S&W Series 2013C Bonds ⁽⁹⁾⁽¹¹⁾ | 94,395 | 94,395 | 94,395 | 94,395 |
| BSWH Series 2015B Bonds ⁽⁹⁾⁽¹²⁾ | – | – | 45,120 | 45,120 |
| BSWH Series 2015C Bonds ⁽⁹⁾⁽¹³⁾ | – | – | 85,775 | 85,775 |
| BSWH Series 2015D Bonds ⁽⁹⁾⁽¹⁴⁾ | – | – | 43,940 | 43,940 |
| S&W Tax-Exempt Note Payable ⁽¹⁵⁾ | 56,225 | 56,225 | 56,225 | 56,225 |
| S&W Note Payable ⁽¹⁶⁾ | 46,000 | 44,000 | 44,000 | 44,000 |
| BHCS Taxable Term Loan | 91,655 | 91,655 | 91,655 | 91,655 |
| Bank Credit Agreement ⁽¹⁷⁾ | 63,080 | 63,080 | 261,080 | – |
| Variable Rate Debt | 843,865 | 839,505 | 1,036,315 | 775,235 |
| Long-Term Debt – Other: ⁽¹⁸⁾ | | | | |
| Capital Leases | 416,115 | 400,256 | 391,922 | 391,922 |
| Other Debt | 56,120 | 51,687 | 54,684 | 54,684 |
| Net Unamortized Original Issue Premium: ⁽¹⁹⁾ | | | | |
| | 22,164 | 22,293 | 21,456 | 73,004 |
| Total Debt | \$ 2,535,509 | \$ 2,799,141 | \$ 2,965,752 | \$ 3,397,040 |
| Current Maturities of Long-Term Debt | (138,322) | (61,464) | (88,946) | (88,946) |
| Total Long-Term Debt | \$ 2,397,187 | \$ 2,737,677 | \$ 2,876,806 | \$ 3,308,094 |
| Unrestricted Net Assets | 4,123,855 | 4,467,694 | 4,565,796 | 4,565,796 |
| Total Capitalization | \$ 6,521,042 | \$ 7,205,371 | \$ 7,442,602 | \$ 7,873,890 |
| Ratio of Long-Term Debt to Capitalization | 36.8% | 38.0% | 38.7% | 42.0% |

[Footnotes to table on following page.]

Footnotes to “System Debt and Capitalization” table:

- (1) This debt, other than the BSWH Taxable Bonds Series 2015 and the Taxable Bonds, incurred through issuance of limited obligation revenue bonds by governmental issuers. Proceeds of the debt were (or, in the case of the Series 2016A Bonds and the Taxable Bonds, are expected to be) loaned to BSW Holdings. Debt is secured by Master Debt issued under the Master Indenture.
- (2) The BSWH Series 2015A Bonds bear interest in a long-term mode with a fixed interest rate. The indenture for such bonds allows them to be converted to bear interest in different interest rate modes or at different fixed interest rates.
- (3) Debt bears interest at variable rates, and is subject to purchase upon optional or mandatory tender in certain circumstances.
- (4) Currently bear interest at an auction rate.
- (5) Currently bear interest at a windows rate. If the BHCS Series 2011B Bonds or the BHCS Series 2013B Bonds are tendered for purchase and not able to be remarketed, BHCS will be obligated to purchase such bonds on the purchase date. See “BONDHOLDERS’ RISKS – The System’s Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds – Demand Obligations” in the Official Statement.
- (6) Currently bear interest at a weekly rate. If the BHCS Series 2011C Bonds are tendered for purchase and not able to be remarketed (and are therefore purchased with funds drawn under the related letter of credit issued to provide payment of such bonds), then BHCS must repay the draw over a set time period. The Northern Trust Company provides the letter of credit relating to the BHCS Series 2011C Bonds that expires June 16, 2017. See “BONDHOLDERS’ RISKS – The System’s Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds – Demand Obligations” in the Official Statement.
- (7) The BHCS Series 2011F Bonds are subject to mandatory tender in 2017, with an obligation of BHCS to purchase such bonds in 2018 if such bonds are not able to be remarketed or refinanced.
- (8) The BHCS Series 2011G Bonds are subject to mandatory tender in 2018, with an obligation of BHCS to purchase such bonds in 2019 if such bonds are not able to be remarketed or refinanced.
- (9) These bonds are subject to mandatory redemption by BHCS, S&W or BSW Holdings, as applicable, upon the occurrence of certain events contained in an agreement with the holder of such bonds. See “BONDHOLDERS’ RISKS – The System’s Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds – Demand Obligations” in the Official Statement.
- (10) The S&W Series 2013B Bonds are subject to mandatory tender in 2023, with an obligation of S&W to repay such bonds over a three year amortization period if such bonds are not able to be remarketed or refinanced.
- (11) The S&W Series 2013C Bonds are subject to mandatory tender in 2019, with an obligation of S&W to repay such bonds on such date if they are not able to be remarketed or refinanced.
- (12) The BSWH Series 2015B Bonds are subject to mandatory tender in 2023, with an obligation of BSW Holdings to redeem such bonds in full on such date if they are not able to be remarketed or refinanced.
- (13) The BSWH Series 2015C Bonds are subject to mandatory tender in 2025, with an obligation of BSW Holdings to redeem such bonds in full on such date if they are not able to be remarketed or refinanced.
- (14) The BSWH Series 2015D Bonds are subject to mandatory tender in 2019, with an obligation of BSW Holdings to redeem such bond in full in 2020 if such bonds are not able to be remarketed or refinanced.
- (15) The S&W Tax-Exempt Note matures in 2017. The note is subject to acceleration prior to its maturity upon the occurrence of certain events contained in an agreement with the holder of such note.
- (16) The S&W Note matures in 2019. The note is subject to acceleration prior to its maturity upon the occurrence of certain events contained in an agreement with the holder of such note.
- (17) Amount drawn under a Credit Agreement, dated as of January 14, 2015, among BSW Holdings, Bank of America, N.A., as the agent, and the lenders party thereto, that permits BSW Holdings to borrow a total revolving commitment amount of \$400 million. As of February 29, 2016, this amount was repaid with available funds of BSW Holdings and a draw under a Credit Agreement, dated as of February 22, 2016 (the “*Bridge Loan Agreement*”), between BSW Holdings and JPMorgan Chase Bank, National Association, an affiliate of one of the underwriters of the Series 2016A Bonds. The outstanding amount under the Bridge Loan Agreement is expected to be repaid with proceeds of the Taxable Bonds.
- (18) Includes various notes, capital leases and interim financing. See “– Capital Leases” above and APPENDICES B-1 and B-2 to the Official Statement.
- (19) Bond premium (discount) is net of unamortized premium and unamortized discount.

INTEREST RATE SWAP TRANSACTIONS

Policy As a part of the management of the System’s debt portfolio, the System uses interest rate swaps to hedge its interest rate exposure. The System’s swaps are governed by an integrated debt and swap policy (the “*Policy*”) approved by the BSW Holdings Board in November 2014 and modified in March 2015. The Policy provides guidelines for the execution and management of fixed and variable rate debt and interest rate swaps, caps, options, basis swaps, rate locks, total return swaps and other similar products with creditworthy counterparties which are consistent with the financial goals and risk tolerances of the System. Among other matters, the Policy allows for the use of derivatives for hedging of interest rate risk in debt offerings while not allowing the use of derivatives for speculation or leverage. The Policy requires approval of all derivative transactions by a majority of the Board (or delegation of such approval to a Board subcommittee). See “BONDHOLDERS’ RISKS – The System’s Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds” in the forepart of this Official Statement. The Policy is reviewed and adjusted annually, or more frequently as needed.

Description of Interest Rate Swaps The System has fixed payor swaps in which System affiliates pay a fixed rate to the counterparty and receive a variable rate defined by a formula related to one-month LIBOR. The System also has a fixed receiver swap in which System affiliates pay a variable rate related to one-month LIBOR to the counterparty and receives a fixed rate. All swaps were put in place originally to hedge existing variable rate debt issues or planned future refundings of existing fixed rate debt in the variable rate debt markets.

The table below presents a summary of the System’s swap transactions, including rates paid and received on the notional amount outstanding under each transaction, as of December 31, 2015. All swap obligations are evidenced by Master Debt under the Master Indenture.

| SUMMARY OF SYSTEM INTEREST RATE SWAP TRANSACTIONS | | | | | |
|---|----------------|------------------|------------------------------|-----------------------|--------------------------|
| Counterparty ⁽¹⁾ | Effective Date | Termination Date | Notional Amount (\$ in 000s) | Interest Rate Payable | Interest Rate Receivable |
| Bank of America, N.A. | 1/15/2016 | 11/15/2050 | \$ 73,740 | 3.975% | Variable |
| Deutsche Bank AG New York Branch | 1/15/2016 | 2/15/2023 | 19,415 | 4.096% | Variable |
| Deutsche Bank AG New York Branch | 1/15/2016 | 2/15/2023 | 83,320 | 4.109% | Variable |
| Deutsche Bank AG New York Branch | 1/18/2011 | 8/15/2041 | 85,775 | 3.518% | Variable |
| Goldman Sachs Bank U.S.A. | 1/15/2016 | 11/15/2050 | 155,760 | 3.991% | Variable |
| Goldman Sachs Bank U.S.A. | 6/11/2008 | 8/15/2041 | 57,220 | 3.646% | Variable |
| Goldman Sachs Bank U.S.A. | 6/11/2008 | 8/15/2046 | 37,175 | 3.641% | Variable |
| JP Morgan Chase Bank, N.A. | 8/15/2022 | 8/15/2045 | 139,055 | 4.431% | Variable |
| JP Morgan Chase Bank, N.A. | 2/2/2011 | 2/15/2018 | 81,200 | Variable | 1.85% |
| Wells Fargo Bank, N.A. | 2/15/2010 | 8/15/2022 | 160,515 | 4.056% | Variable |
| Wells Fargo Bank, N.A. | 1/15/2016 | 2/15/2028 | 83,320 | 3.987% | Variable |
| Wells Fargo Bank, N.A. | 1/18/2011 | 8/15/2046 | 56,225 | 3.518% | Variable |

(1) Counterparty line items in the table may include multiple swap confirmations.

Each of the swap transactions described above may be terminated prior to its scheduled termination date. In addition, the swap transactions with Wells Fargo Bank, N.A. and Deutsche Bank AG have mandatory early termination dates in 2028 and 2023, respectively. Upon early termination of a swap transaction, BSW Holdings, BHCS, and S&W may owe a termination payment to the related swap counterparty, or the related

swap counterparty may owe a termination payment to BSW Holdings, BHCS, and S&W. Such termination payments would be based upon the market value of the applicable swap transaction on the date of termination and could be substantial. Certain of the interest rate swap agreements also require the System entity party to such agreement to post collateral, based on the System's debt ratings, to secure obligations that would be owed to the counterparties if the interest rate swap agreements are terminated, regardless of whether or not such transactions are actually terminated, and the amount of collateral required to be posted could be substantial. As of February 29, 2016, the System had posted approximately \$24.7 million in collateral. See "BONDHOLDERS' RISKS – The System's Financial Obligations Could Increase or be Accelerated and Deplete Its Available Funds" in the Official Statement.

RETIREMENT PLANS

The System continues to maintain separate defined contribution retirement plans. The North Texas Division maintains two 401(k) plans, one covering employees of BHCS and one covering employees of Baylor Affiliated Services. The provisions of the plans are identical and they are administered by Aon Hewitt. The 401(k) plans are qualified plans under the Code and are subject to ERISA. The plans allow for immediate eligibility, both employee and employer contributions with employer contributions vesting on a 5-year graded schedule.

The Central Texas Division maintains two defined contribution plans, a 403(b) plan for employee contributions and a profit sharing plan for employer contributions, both administered by Vanguard. Both plans are qualified plans under the Code and are subject to ERISA. The 403(b) plan allows for immediate eligibility and the profit sharing plan requires the completion of one year of service and attainment of age 21 to participate. Employer contributions vest on a 3-year cliff schedule.

As of December 31, 2015 the System had four frozen defined benefit plans. Three of the four plans are subject to ERISA and all are being funded in accordance with regulatory requirements. The Central Texas Division also provides an unfunded defined benefit medical and dental plan to retirees. For further discussion of the System's retirement plans, see the "Retirement Benefits" note to the System's audited financial statements for the fiscal year ended June 30, 2015 in APPENDIX B-1.

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CASH AND INVESTMENTS

A summary of cash and investments of the System as of each of the dates indicated is included below.

| SUMMARY OF SYSTEM CASH AND INVESTMENTS (\$ THOUSANDS) | | | |
|--|---------------------------|--------------|-------------------------------|
| | As of June 30, | | As of December 31, |
| | 2014 | 2015 | 2015 |
| Cash and cash equivalents ⁽¹⁾ | \$ 743,908 | \$ 1,185,285 | \$ 949,523 |
| Short-term investments ⁽²⁾ | 72,486 | 71,872 | 83,614 |
| Long-term investments ⁽³⁾ | 3,002,227 | 3,302,173 | 3,282,068 |
| Total cash and investments | \$ 3,818,621 | \$ 4,559,330 | \$ 4,315,205 |
| Less: Restricted cash and investments ⁽⁴⁾ | 740,269 | 659,969 | 642,773 |
| Total unrestricted cash and investments | \$ 3,078,352 | \$ 3,899,361 | \$ 3,672,432 |
| Average daily operating expenses (less depreciation) | \$ 16,637 | \$ 17,863 | \$ 18,874 |
| Unrestricted days cash on hand ⁽⁵⁾ | 185.0 | 218.3 | 194.6 |

(1) Cash and cash equivalents are composed of assets that may be immediately converted to cash.

(2) Short-term investments are assets that are convertible to cash in one year or less.

(3) Long-term investments are comprised of U.S. small, mid and larger capitalization stocks, international stocks, intermediate term fixed income securities, non-directional hedge funds, real estate, and private equity.

(4) Restricted cash and investments is the sum of the restricted long-term investments, assets restricted by donors, assets held by bond trustees and assets required to meet self-insurance obligations.

(5) Unrestricted days cash on hand is calculated as unrestricted cash and investments divided by average daily operating expenses.

In addition to cash on hand, the System has a \$400 million revolving line of credit with a group of banks that is used for capital expenditure financing and liquidity requirements. There were no borrowings under this facility as of February 29, 2016.

INVESTMENT POLICY

BSW Holdings manages substantially all of the System's cash, short-term and long-term investments through an investment policy that is overseen by the Finance and Investment Committee of the Board. BSW Holdings retains various professional investment managers and advisors to oversee its investments in different classes of securities according to asset allocation targets that are set in conjunction with the System's investment policy and the System's overall strategic and financial plan. The various investment managers have individual guidelines for allowable investments, style, objectives, concentration limits, credit quality and other relevant restrictions, and are measured against various benchmarks on a routine basis. The overall investment allocation guidelines as of December 31, 2015 call for allocations of 35% public and private debt, 30% public and private equity, 15% risk parity and global assets, 10% hedge funds, and 10%

real assets. At December 31, 2015 and June 30, 2015, the System's investment portfolio was in material compliance with the then current investment policy allocations and guidelines.

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OTHER INFORMATION

ACCREDITATIONS AND CERTIFICATIONS

The System's hospitals are licensed by the Texas Department of State Health Services and are accredited by The Joint Commission, DNV Healthcare Inc. or another national accreditation organization approved by the Centers for Medicare and Medicaid Services. In addition, all hospital laboratories are College of American Pathologists accredited. The System's hospital affiliates are also approved by, or are members of, one or more of the following organizations: American Hospital Association, Texas Hospital Association, Texas Association of Voluntary Hospitals, Voluntary Hospitals of America, Council of Teaching Hospitals, Association of American Medical Colleges, Children's Hospitals Association, and the Association for Hospital Medical Education. The American Association of Blood Banks accredits the blood bank located in the Central Texas Division. All of the System's hospitals are approved participants in Medicare (Title XVIII), Medicaid (State of Texas), and other federal programs except for the Continuing Care Hospital, which is not a Medicaid participant.

FRAUD AND ABUSE

The federal government has increased its scrutiny of potential billing errors in Medicare, Medicaid, and other federal health insurance programs. See "BONDHOLDERS' RISKS – If the System Improperly Provides or Claims Compensation for Services, It Could Lose its Ability to Serve Medicare or Medicaid Beneficiaries or Incur Substantial Penalties" in the Official Statement. Many health care organizations have implemented voluntary compliance programs as a proactive commitment to reduce the potential for fraud and/or abuse. The System has a voluntary program that has been operating since formation of the System in October 2013. Both BHCS and S&W had preexisting compliance programs that were started in 1998 and 1997, respectively. The System program includes auditing and monitoring of patient billings, research, and HIPAA privacy and security, as well as education programs to keep staff informed of regulatory updates and changes. The System is committed to a compliance program that minimizes billing errors, and management is actively involved in ensuring that regulations are followed. The System also operates an internal audit program that audits business services and processes. The compliance and internal audit groups report to the Board through the Audit and Compliance Committee.

INSURANCE AND RISK MANAGEMENT

The System provides for the basic self-insured retention limits for hospital professional liability ("HPL"), general liability ("GL") and physician professional liability ("PPL") coverage through Baylor Scott & White Assurance, SPC, a wholly owned insurance company of BSW Holdings domiciled in the Cayman Islands (the "Captive Insurer"). The System's Risk Management Department is responsible for in-house management of all claims and suits. Occurrences are monitored through the Department by attorneys employed by BSW Health.

Excess policies for HPL, GL and PPL claims and other lines are reinsured through the Captive Insurer. The excess policies are reinsured by multiple companies.

The System covers legacy employee workers' compensation claims through a deductible policy. Employee occupational injury coverage is provided through a self-administered ERISA benefit plan with an excess employer's indemnity policy.

The System also purchases insurance for other lines of coverage with various limits of liability as follows: property including business interruption, pollution, security guard and law enforcement errors and omissions, general liability for fire extinguishers, volunteers, physician tail coverage for acquired entities, crime, fiduciary, international travel, business automobile including ambulances, helipad and non-owned aircraft liability, directors and officers liability including employment practices liability, fiduciary liability, cyber liability, regulatory liability, and managed care errors and omissions liability.

Through leadership involvement in oversight and decision making, the System is proactive in its enterprise risk management program. The System's Risk Management Department works with the Finance Department on actuarial evaluation and the financial aspects of the captive program.

LITIGATION AND PROCEEDINGS

As of the date of this Official Statement, there is no litigation or proceeding pending or, to the knowledge of the System, threatened against it or any of the members of the System except (a) litigation, proceedings or claims involving professional liability claims or general liability claims in which the probable ultimate recoveries and the estimated costs and expenses of defense, in the opinion of counsel to the System, will be entirely within applicable insurance policy limits (subject to applicable deductibles or self-insured retentions) or not in excess of the total available reserves held under applicable self-insurance programs, and (b) litigation, proceedings or claims involving other types of claims which if adversely determined will not have a material adverse effect on the operations or financial condition of the System, taken as a whole.

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APPENDIX B-1

**AUDITED COMBINED FINANCIAL STATEMENTS
OF BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES FOR THE YEAR
ENDED JUNE 30, 2015 AND THE NINE MONTHS ENDED JUNE 30, 2014**

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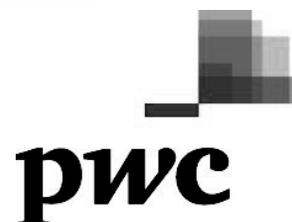
Baylor Scott & White

HEALTH

**Baylor Scott & White Holdings
and Its Controlled Affiliates**

**Combined Financial Statements and
Supplementary Information**

**For the Year Ended June 30, 2015 and the
Nine Months Ended June 30, 2014**



**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Combined Financial Statements and Supplementary Information

For the Year Ended June 30, 2015 and the Nine Months Ended June 30, 2014

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Combined Financial Statements and Supplementary Information

For the Year Ended June 30, 2015 and the Nine Months Ended June 30, 2014

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Independent Auditor's Report

To the Board of Trustees
Baylor Scott & White Holdings:

We have audited the accompanying combined financial statements of Baylor Scott & White Holdings and its controlled affiliates ("the Company"), which comprise the combined balance sheets as of June 30, 2015 and 2014, and the related combined statements of operations and changes in net assets, and of cash flows for the year ended June 30, 2015 and the nine months ended June 30, 2014.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of the combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Baylor Scott & White Holdings and its controlled affiliates as of June 30, 2015 and 2014, and the results of their operations and their cash flows for the year ended June 30, 2015 and the nine months ended June 30, 2014 in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the basic combined financial statements taken as a whole. The other community benefits information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly we do not express an opinion or provide any assurance on it.

PricewaterhouseCoopers LLP

November 11, 2015

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

COMBINED BALANCE SHEETS - JUNE 30, 2015 and 2014
(In thousands)

| ASSETS | <u>2015</u> | <u>2014</u> | LIABILITIES AND NET ASSETS | <u>2015</u> | <u>2014</u> |
|---|---------------------|---------------------|--|-------------------------|-------------------------|
| CURRENT ASSETS: | | | CURRENT LIABILITIES: | | |
| Cash and cash equivalents | \$ 1,185,285 | \$ 743,908 | Current maturities of long-term debt and capital lease obligations | \$ 61,464 | \$ 138,322 |
| Short-term investments | 71,872 | 72,486 | Long-term debt subject to short-term remarketing arrangements | 95,000 | 95,000 |
| THVG funds due from United Surgical Partners, Inc. | 58,876 | 63,271 | Trade accounts payable | 278,653 | 226,669 |
| Accounts receivable: | | | Payable under securities lending program | - | 180,833 |
| Patient, net of allowance for uncollectibles of \$346,047 in 2015 and \$373,054 in 2014 | 637,637 | 611,386 | Accrued liabilities: | | |
| Premiums | 41,161 | 52,798 | Payroll related | 388,583 | 257,543 |
| Other | 240,758 | 206,895 | Third-party programs | 57,031 | 52,013 |
| Invested collateral - securities lending program | - | 180,833 | Medical claims payable | 27,422 | 21,874 |
| Other current assets | <u>201,215</u> | <u>182,444</u> | Other | <u>265,991</u> | <u>301,286</u> |
| | | | Total current liabilities | <u>1,174,144</u> | <u>1,273,540</u> |
| Total current assets | <u>2,436,804</u> | <u>2,114,021</u> | | | |
| LONG-TERM INVESTMENTS: | | | LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current maturities | 2,642,677 | 2,302,187 |
| Unrestricted | 2,642,204 | 2,259,817 | | | |
| Restricted | <u>451,244</u> | <u>469,381</u> | OTHER LONG-TERM LIABILITIES: | | |
| Total long-term investments | <u>3,093,448</u> | <u>2,729,198</u> | Self insurance and other insurance liabilities | 80,104 | 83,748 |
| ASSETS WHOSE USE IS LIMITED: | | | Interest rate swap liabilities, net | 258,531 | 203,312 |
| Other designated assets | 78,323 | 67,654 | Other | <u>219,319</u> | <u>182,163</u> |
| Self insurance reserves | 82,268 | 82,184 | Total other long-term liabilities | <u>557,954</u> | <u>469,223</u> |
| Funds held by bond trustee | <u>48,134</u> | <u>121,050</u> | Total liabilities | <u>4,374,775</u> | <u>4,044,950</u> |
| Total assets whose use is limited | <u>208,725</u> | <u>270,888</u> | | | |
| ASSETS HELD FOR SALE | 9,157 | 3,635 | COMMITMENTS AND CONTINGENCIES | | |
| PROPERTY AND EQUIPMENT, net | 3,371,810 | 3,319,123 | NONCONTROLLING INTERESTS – REDEEMABLE | 313,005 | 281,160 |
| CONTRIBUTIONS RECEIVABLE, net | 70,365 | 61,483 | NET ASSETS: | | |
| INVESTMENTS OF INSURANCE SUBSIDIARY | - | 2,141 | Unrestricted - attributable to BSWH | 4,326,067 | 3,995,319 |
| INTEREST IN NET ASSETS OF RELATED FOUNDATIONS | 4,035 | 4,217 | Unrestricted - noncontrolling interests-nonredeemable | <u>141,627</u> | <u>128,536</u> |
| OTHER LONG-TERM ASSETS: | | | Total unrestricted net assets | 4,467,694 | 4,123,855 |
| Equity investments in unconsolidated entities | 70,474 | 73,021 | Temporarily restricted | 292,644 | 288,779 |
| Goodwill and intangible assets, net | 390,743 | 357,905 | Permanently restricted | <u>239,299</u> | <u>230,634</u> |
| Other | <u>31,856</u> | <u>33,746</u> | Total net assets | <u>4,999,637</u> | <u>4,643,268</u> |
| Total other long-term assets | <u>493,073</u> | <u>464,672</u> | Total liabilities and net assets | <u>\$ 9,687,417</u> | <u>\$ 8,969,378</u> |
| Total assets | <u>\$ 9,687,417</u> | <u>\$ 8,969,378</u> | | | |

See accompanying notes.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

FOR THE YEAR ENDED JUNE 30, 2015 AND THE
NINE MONTHS ENDED JUNE 30, 2014

(In thousands)

| | <u>Year Ended</u> <u>2015</u> | <u>Nine Months</u> <u>Ended</u> <u>2014</u> |
|---|----------------------------------|---|
| OPERATING REVENUE: | | |
| Net patient care revenue | \$ 6,975,386 | \$ 4,666,765 |
| Less patient related bad debt expense | <u>581,260</u> | <u>341,632</u> |
| Net patient care revenue, net of patient related bad debt expense | 6,394,126 | 4,325,133 |
| Premium revenue | 695,853 | 494,687 |
| Other operating revenue | 376,736 | 249,985 |
| Net assets released from restrictions for operations | <u>69,211</u> | <u>53,187</u> |
| Total operating revenue | <u>7,535,926</u> | <u>5,122,992</u> |
| OPERATING EXPENSES: | | |
| Salaries, wages, and employee benefits | 3,530,919 | 2,477,660 |
| Supplies | 1,271,437 | 857,273 |
| Other operating expenses | 1,344,336 | 973,678 |
| Medical claims | 270,873 | 176,967 |
| (Gains) losses on fixed asset sales and disposals, net | (840) | 346 |
| Depreciation and amortization | 343,736 | 265,634 |
| Interest | <u>93,563</u> | <u>66,654</u> |
| Total operating expenses | <u>6,854,024</u> | <u>4,818,212</u> |
| INCOME FROM OPERATIONS BEFORE MERGER COSTS | <u>681,902</u> | <u>304,780</u> |
| MERGER COSTS | <u>9,571</u> | <u>27,382</u> |
| INCOME FROM OPERATIONS | <u>672,331</u> | <u>277,398</u> |
| NONOPERATING GAINS (LOSSES): | | |
| Gains on investments, net | 56,772 | 232,215 |
| Interest rate swap activity | (69,244) | (50,134) |
| Contributions | 1,792 | 5,667 |
| Equity in losses in unconsolidated entities | (3,958) | (5,712) |
| Loss from extinguishment of debt | (71,379) | (254) |
| Other | <u>1,608</u> | <u>(3,166)</u> |
| Total nonoperating (losses) gains | <u>(84,409)</u> | <u>178,616</u> |
| REVENUE AND GAINS IN EXCESS OF EXPENSES AND LOSSES BEFORE INCOME TAXES | 587,922 | 456,014 |
| LESS INCOME TAX EXPENSE | <u>8,375</u> | <u>8,414</u> |
| REVENUE AND GAINS IN EXCESS OF EXPENSES AND LOSSES | 579,547 | 447,600 |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS - continued

FOR THE YEAR ENDED JUNE 30, 2015 AND THE
NINE MONTHS ENDED JUNE 30, 2014

(In thousands)

| | <u>Year Ended</u> 2015 | <u>Nine Months</u> <u>Ended</u> 2014 |
|--|---------------------------|--|
| OTHER CHANGES IN UNRESTRICTED NET ASSETS: | | |
| Unrealized gains on investments, net | \$ 5,171 | \$ 8,094 |
| Net assets released from restrictions for capital expenditures | 7,012 | 27,531 |
| Other changes in net assets attributable to noncontrolling interests - nonredeemable | (35,774) | (30,913) |
| Revenue and gains in excess of expenses and losses attributable to noncontrolling interests - redeemable | (196,964) | (125,707) |
| Other | <u>(15,153)</u> | <u>(244)</u> |
| INCREASE IN UNRESTRICTED NET ASSETS | <u>343,839</u> | <u>326,361</u> |
| CHANGES IN TEMPORARILY RESTRICTED NET ASSETS: | | |
| Contributions | 75,360 | 53,191 |
| Realized gains and investment income, net | 29,934 | 19,940 |
| Unrealized (losses) gains on investments, net | (22,974) | 20,611 |
| Change in value of split-interest agreements | (3) | (670) |
| Net assets released from restrictions for operations | (69,211) | (53,187) |
| Net assets released from restrictions for capital expenditures | (7,012) | (27,531) |
| Changes in net assets of related foundations | (210) | (3,186) |
| Other | <u>(2,019)</u> | <u>1,675</u> |
| INCREASE IN TEMPORARILY RESTRICTED NET ASSETS | <u>3,865</u> | <u>10,843</u> |
| CHANGES IN PERMANENTLY RESTRICTED NET ASSETS: | | |
| Contributions | 5,931 | 6,837 |
| Realized gains and investment income, net | 662 | 337 |
| Unrealized (losses) gains on investments, net | (382) | 219 |
| Change in value of split-interest agreements | 351 | 321 |
| Changes in net assets of related foundations | 28 | 30 |
| Other | <u>2,075</u> | <u>(1,897)</u> |
| INCREASE IN PERMANENTLY RESTRICTED NET ASSETS | <u>8,665</u> | <u>5,847</u> |
| INCREASE IN NET ASSETS | <u>356,369</u> | <u>343,051</u> |
| NET ASSETS, beginning of period | <u>4,643,268</u> | <u>4,300,217</u> |
| NET ASSETS, end of period | <u>\$ 4,999,637</u> | <u>\$ 4,643,268</u> |

See accompanying notes.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED JUNE 30, 2015 AND THE
NINE MONTHS ENDED JUNE 30, 2014

(In thousands)

| | <u>Year Ended</u> 2015 | <u>Nine Months</u> <u>Ended</u> 2014 |
|---|---------------------------|--|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Increase in net assets | \$ 356,369 | \$ 343,051 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Loss from extinguishment of debt | 5,999 | 254 |
| Unrealized losses (gains) on investments, net | 168,089 | (128,817) |
| Realized gains on investments, net | (182,144) | (110,133) |
| Unrealized losses on interest rate swap, net | 55,219 | 40,415 |
| Contributions restricted for long-term purposes | (5,931) | (6,837) |
| Patient related bad debt expense | 581,260 | 341,632 |
| Depreciation and amortization | 343,736 | 265,634 |
| (Gains) losses on fixed asset sales or disposals, net | (840) | 346 |
| Change in value of split-interest agreements | (348) | 349 |
| Deferred rent | 12,876 | 4,489 |
| Other changes attributable to noncontrolling interests | 232,738 | 156,620 |
| Changes in operating assets and liabilities (net of acquisition): | | |
| Increase in net patient accounts receivable | (604,654) | (367,663) |
| Increase in other accounts receivable | (17,421) | (24,327) |
| Increase in other assets | (23,140) | (7,378) |
| Increase in trade accounts payable and accrued liabilities | 162,013 | 157,563 |
| Increase (decrease) in other liabilities | <u>34,650</u> | <u>(35,554)</u> |
| Net cash provided by operating activities | <u>1,118,471</u> | <u>629,644</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (426,141) | (354,616) |
| Cash proceeds from sales of assets | 21,031 | 5,326 |
| Cash paid for acquisitions, net of cash received | (24,579) | (10,635) |
| Decrease (increase) in THVG funds due from United Surgical Partners, Inc. | 4,395 | (6,913) |
| (Increase) decrease in trading investments | (341,305) | 115,737 |
| Payments on interest rate swaps, net | (14,025) | (9,719) |
| Purchases of other than trading investments | (35,700) | (36,495) |
| Sales of other than trading investments | 28,838 | 31,036 |
| Decrease in investments of insurance subsidiaries | 2,141 | 20 |
| Decrease in invested collateral-securities lending program | 180,833 | 7,652 |
| Decrease in assets whose use is limited | <u>62,163</u> | <u>106,571</u> |
| Net cash used in investing activities | <u>(542,349)</u> | <u>(152,036)</u> |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF CASH FLOWS - continued

FOR THE YEAR ENDED JUNE 30, 2015 AND THE
NINE MONTHS ENDED JUNE 30, 2014

(In thousands)

| | Year Ended 2015 | Nine Months Ended 2014 |
|--|---------------------|------------------------------|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Principal payments on long-term debt | \$ (513,870) | \$ (39,536) |
| Proceeds from issuance of long-term debt | 769,086 | 17,927 |
| Decrease in payable under securities lending program | (180,833) | (7,652) |
| Distributions to noncontrolling interests owners | (227,874) | (151,900) |
| Purchases of noncontrolling interests | (9,197) | (7,839) |
| Sales of noncontrolling interests | 23,842 | 30,427 |
| Cash receipts restricted for long-term purposes | 5,392 | 11,280 |
| Annuity payments to beneficiaries | <u>(1,291)</u> | <u>(982)</u> |
| Net cash used in financing activities | <u>(134,745)</u> | <u>(148,275)</u> |
| | | |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | <u>441,377</u> | <u>329,333</u> |
| | | |
| CASH AND CASH EQUIVALENTS, beginning of period | <u>743,908</u> | <u>414,575</u> |
| | | |
| CASH AND CASH EQUIVALENTS, end of period | <u>\$ 1,185,285</u> | <u>\$ 743,908</u> |
| SUPPLEMENTAL CASH FLOW DATA: | | |
| Cash paid for interest | <u>\$ 92,095</u> | <u>\$ 61,037</u> |
| Cash paid for income tax | <u>\$ 10,553</u> | <u>\$ 9,094</u> |
| Property and equipment acquired under capital leases | <u>\$ 3,070</u> | <u>\$ 7,280</u> |
| (Decrease) increase in accounts payable due to property and equipment received but not paid | <u>\$ (7,544)</u> | <u>\$ 10,855</u> |

See accompanying notes.

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BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements

For The Year Ended June 30, 2015 And The
Nine Months Ended June 30, 2014

1. ORGANIZATION

Effective October 1, 2013, Baylor Health Care System (BHCS) and Scott & White Healthcare (SWH), both Texas nonprofit corporations, consummated their affiliation pursuant to an Affiliation Agreement (the "Agreement") dated June 19, 2013. BHCS and SWH formed BSW Health, a Texas nonprofit corporation now known as Baylor Scott & White Holdings (BSW Holdings), and BSW Health Service, a Texas nonprofit corporation now known as Baylor Scott & White Health (BSW Health).

While the receipt of Internal Revenue Service (IRS) tax-exempt and public charity determination letters for BSW Holdings and BSW Health was pending, BHCS and SWH formed two Texas limited liability companies, Baylor Scott & White Health LLC (BSW Holdings LLC) and Baylor Scott & White Health Service LLC (BSW Health LLC). On December 31, 2013, BSW Holdings and BSW Health each received a favorable determination letter from the IRS regarding their tax-exempt and public charity status. Effective March 1, 2014, BSW Holdings LLC was merged into BSW Holdings and BSW Health LLC was merged into BSW Health. BSW Holdings is now the sole member of BHCS and SWH and has control and substantial reserved powers over all BHCS and SWH material affiliates. BHCS and its material affiliates are collectively referred to as "Baylor". SWH and its material affiliates are collectively referred to as "Scott & White". BSW Holdings and its affiliates are collectively referred to as the "System" or "BSWH".

BSW Holdings has accounted for the combination as a merger of not-for-profit entities under Accounting Standards Codification (ASC) 958-805, "*Not-for-Profit Entities: Business Combinations*" resulting in a new reporting entity effective October 1, 2013, the merger date, with no activities before the merger. Therefore, the combined assets, liabilities and net assets of Baylor and Scott & White are included in the accompanying combined financial statements as of the merger date at their historical basis under the carryover method with adjustments to conform the individual accounting policies of Baylor and Scott & White and to eliminate intra-entity balances. The accompanying financial statements include activity of the newly

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

combined entity after October 1, 2013. The major classes of assets, liabilities and net assets that were combined at September 30, 2013 are as follows (in thousands):

| | <u>Baylor</u> | <u>Scott and White</u> | <u>Total</u> |
|---|----------------|------------------------|----------------|
| ASSETS | | | |
| Cash and investments | \$ 2,570,341 | \$ 893,332 | \$ 3,463,673 |
| Property and equipment, net | 2,120,999 | 1,098,753 | 3,219,752 |
| Other assets | 1,330,483 | 432,118 | 1,762,601 |
| LIABILITIES | | | |
| Long-term and capital lease obligations | 1,313,887 | 1,139,860 | 2,453,747 |
| Other liabilities | 1,008,262 | 437,152 | 1,445,414 |
| Noncontrolling interests redeemable | <u>246,648</u> | <u>-</u> | <u>246,648</u> |
| NET ASSETS | | | |
| Unrestricted | 3,086,123 | 711,371 | 3,797,494 |
| Temporarily restricted | 183,576 | 94,360 | 277,936 |
| Permanently restricted | \$ 183,327 | \$ 41,460 | \$ 224,787 |

Transition and integration are on-going with the System incurring approximately \$9,571,000 and \$27,382,000 in costs during the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively, as a result of the transaction, which are included in merger costs in the combined statements of operations and changes in net assets.

The combined financial statements include the accounts of BSW Holdings, BSW Health, BHCS, SWH, Baylor University Medical Center (BUMC), Scott & White Memorial Hospital (SWMH), Scott & White Health Plan (the “Health Plan” or “SWHP”), five foundations, nineteen community and specialty medical centers located throughout the Dallas and Fort Worth metroplex and the central Texas area, two wholly owned insurance subsidiaries, Baylor Quality Health Alliance, LLC, an accountable care organization, four physician practice organizations, HealthTexas Provider Network, Scott & White Clinic, Hillcrest Family Health Center, and Hillcrest Physician Services, and other related entities. Investments in certain related entities with 50.0% or less ownership are accounted for using the equity method. The transactions and balances for investments in certain related entities with greater than 50.0% ownership or where the System exercises board control are included in the accompanying combined financial statements with related noncontrolling interests reported in the combined financial statements. These entities include the following: Texas Health Ventures Group, LLC (THVG), providing short stay hospital and outpatient surgery services, BIR JV, LLP, providing rehabilitation services, BTDI JV, LLP, providing imaging services, EBD JV, LLP and ESWCT, LLC, providing emergency medical services and THVG Bariatric, LLC, providing bariatric services. All significant intercompany accounts and transactions among entities included in the combined financial statements have been eliminated.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

As required by ASC 958-805-50-3, the following table presents supplemental pro forma information for the System for the year ended June 30, 2014, as if the merger had occurred on July 1, 2013. The following supplemental pro forma information is not audited, and is as follows (in thousands):

| | <u>Total Operating Revenue</u> | <u>Change in Unrestricted Net Assets</u> | <u>Change in Temporarily Restricted Net Assets</u> | <u>Change in Permanently Restricted Net Assets</u> |
|---------------|--|--|--|--|
| Baylor | \$ 4,503,300 | \$ 494,016 | \$ 28,324 | \$ 9,940 |
| Scott & White | <u>2,265,280</u> | <u>(28,688)</u> | <u>(11,797)</u> | <u>1,675</u> |
| Total | <u>\$ 6,768,580</u> | <u>\$ 465,328</u> | <u>\$ 16,527</u> | <u>\$ 11,615</u> |

As both organizations had different fiscal year ends, the supplementary information above is presented only for purposes of additional analysis and not as a presentation of financial position and results of operations. This information does not reflect all eliminations and reclassifications that are required by generally accepted accounting principles. Management does not believe this information would be reflective of a twelve month fiscal year post-merger and is not indicative of what the financial position and results of operations would have been for the combined entity had the merger occurred on July 1, 2013.

The following summarizes significant changes in the System in 2015 and 2014:

THVG

BUMC has a majority ownership of 50.1% in THVG with USP North Texas, Inc. (USP), a Texas corporation and subsidiary of United Surgical Partners, Inc. (USPI) holding the remaining 49.9%. THVG had net patient care revenue included in the System's combined financial statements of approximately \$741,841,000 and \$501,249,000, for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively.

THVG completed the acquisition of three outpatient centers in 2014. In connection with these acquisitions, THVG recorded goodwill and intangible assets, net, of approximately \$15,477,000, fixed assets of approximately \$630,000 and other net liabilities of approximately \$16,107,000 in 2014.

THVG completed the acquisition of one surgical hospital in 2015. THVG recorded goodwill and intangible assets, net, of approximately \$33,500,000, fixed assets of approximately \$4,573,000 and other net liabilities of approximately \$38,073,000 in 2015.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

2. SIGNIFICANT ACCOUNTING POLICIES

The accompanying combined financial statements of the System have been prepared in conformity with accounting principles generally accepted in the United States. The following is a summary of the significant accounting and reporting policies used in preparing the financial statements.

Adoption of New Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-04, *“Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date.”* The ASU requires measurement of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, as the sum of (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. Additionally, the amendment requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments are to be applied retrospectively to all prior periods presented for those obligations within the scope of the ASU that exist at the beginning of an entity’s fiscal year of adoption. The System applied the provisions of ASU 2013-04 in fiscal year 2015.

In April 2014, the FASB issued ASU 2014-08, *“Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.”* This ASU amends the requirements for reporting discontinued operations by removing the following conditions in the current reporting requirements of discontinued operations: elimination of the operations and cash flows of the component from ongoing operations and the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. Additionally, only if the disposal represents a strategic shift, having a major effect on an entity’s operations and financial results will the disposal of components be reported as discontinued operations. This amendment also adds that the disposal of an equity method investment that meets the definition of discontinued operations or a business or nonprofit activity that, on acquisition, meets the criteria to be classified as held for sale is to be reported in discontinued operations. The System applied the provisions of ASU 2014-08 in fiscal year 2015.

In June 2015, FASB issued ASU 2015-10, *“Technical Corrections and Improvements.”* This ASU clarifies the Codification, corrects unintended application of guidance, or makes minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. The System applied the provisions of ASU 2015-10 in fiscal year 2015.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

Other Accounting Pronouncements

In May 2014, FASB issued ASU 2014-09, “*Revenue from Contracts with Customers (Topic 606)*,” which supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) 605, “*Revenue Recognition*.” This ASU addresses when an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The System has not evaluated all of the provisions, which are effective for annual reporting periods beginning after December 15, 2017, as amended by ASU 2015-14.

In August 2014, the FASB issued ASU 2014-15, “*Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*.” This ASU amendment requires management to assess an entity’s ability to continue as a going concern. Management should evaluate whether conditions or events, considered in the aggregate, exist that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued. The System has not evaluated all of the provisions of ASU 2014-15, which are effective for fiscal years ending after December 15, 2016.

In January 2015, FASB issued ASU 2015-01, “*Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*.” The amendments in ASU 2015-01 eliminate the concept of extraordinary items in financial statements. The System has not evaluated all of the provisions of ASU 2015-01, which are effective for fiscal years beginning after December 15, 2015, and interim periods thereafter.

In February 2015, FASB issued ASU 2015-02, “*Consolidation: Amendments to the Consolidation Analysis*.” The amendments in ASU 2015-02 improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The System has not evaluated all of the provisions of ASU 2015-02, which are effective for fiscal years beginning after December 15, 2015, and interim periods within those years.

In April 2015, FASB issued ASU 2015-03, “*Interest - Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*.” The amendments in ASU 2015-03 are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability, consistent with debt discounts. The System has not evaluated all of the provisions of ASU 2015-03, which are effective for fiscal years beginning after December 15, 2015, and interim periods within those years.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

In April 2015, FASB issued ASU 2015-05, “*Intangibles - Goodwill and Other - Internal-Use Software: Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement.*” The amendments in ASU 2015-05 provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. BSWH has not evaluated all of the provisions of ASU 2015-05, which are effective for fiscal years beginning after December 15, 2015, and interim periods within those years.

In May 2015, FASB issued ASU 2015-07, “*Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).*” This ASU removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. The System has not evaluated all of the provisions, which are effective for fiscal years beginning after December 15, 2015, and interim periods within those years.

In May 2015, FASB issued ASU 2015-09, “*Disclosures about Short-Duration Contracts.*” This ASU requires insurance entities to disclose for annual reporting periods information about the liability for unpaid claims and claim adjustment expenses. The amendments also require insurance entities to disclose information about significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements. In addition, the amendments require insurance entities to disclose for annual and interim reporting periods a roll-forward of the liability for unpaid claims and claim adjustment expenses. For health insurance claims, the amendments require the disclosure of the total of incurred-but-not-reported liabilities and expected development on reported claims included in the liability for unpaid claims and claim adjustment expenses. The System has not evaluated all of the provisions, which are effective for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2016.

In July 2015, FASB issued ASU 2015-11, “*Simplifying the Measurement of Inventory.*” This ASU requires an entity to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

inventory that is measured using first-in, first-out (FIFO) or average cost. The System has not evaluated all of the provisions, which are effective for fiscal years beginning after December 15, 2016, and interim periods within those years.

In August 2015, FASB issued ASU 2015-15, *“Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting).”* This ASU requires an entity to defer and present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The System has not evaluated all of the provisions of ASU 2015-15, which are effective for fiscal years beginning after December 15, 2015, and interim periods within those years.

In September 2015, FASB issued ASU 2015-16, *“Simplifying the Accounting for Measurement-Period Adjustments.”* This ASU requires that an acquirer recognize adjustments to estimated amounts that are identified during the measurement period and any related income effects in the reporting period in which the adjustment amounts are determined. The ASU also requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the estimated amounts had been recognized as of the acquisition date. The System has not evaluated all of the provisions, which are effective for fiscal years beginning after December 15, 2015, and interim periods within those years.

Cash and Cash Equivalents

Cash equivalents are defined as investments which have original maturities of three months or less. Cash equivalents consist primarily of securities issued by the United States government or its agencies, certificates of deposit, commercial paper and dollar denominated foreign issuer investments.

THVG Funds Due From United Surgical Partners, Inc.

THVG participates in a shared services accounts payable program with USPI, wherein USPI has custody of substantially all of THVG’s cash, paying THVG and its facilities interest income on the net balance at prevailing market rates. Amounts held by USPI on behalf of THVG totaled approximately \$58,876,000 and \$63,271,000 at June 30, 2015 and 2014, respectively. The funds due from USPI are available on demand.

Investments

The System has designated all of its investments as trading except for those investments held at the Baptist Foundation of Texas (BFT) for the benefit of the BHCS Foundation, the

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

investments of All Saints Health Foundation and the investments of the Health Plan. For all trading investments, the interest and dividends, realized gains and unrealized gains (losses) are included in gains on investments, net, in the accompanying combined statements of operations and changes in net assets. For other than trading investments, interest and dividends and realized gains (losses) are included in gains on investments, net, unless restricted by donor. Unrealized gains (losses) on other than trading investments are included in other changes in unrestricted net assets, unless restricted by donor.

Interest and dividends, realized gains and unrealized gains (losses) for the year ended June 30, 2015 and the nine months ended June 30, 2014 consisted of the following (in thousands):

| | Year Ended June 30, 2015 | | | |
|---|---------------------------|-------------------|------------------------------|------------------|
| | Interest and dividends | Realized gains | Unrealized (losses) gains | Total |
| Nonoperating gains (losses) | \$ 39,854 | \$ 166,822 | \$ (149,904) | \$ 56,772 |
| Other changes in unrestricted net assets | - | - | 5,171 | 5,171 |
| Changes in temporarily restricted net assets | 15,274 | 14,660 | (22,974) | 6,960 |
| Changes in permanently restricted net assets | - | 662 | (382) | 280 |
| | <u>\$ 55,128</u> | <u>\$182,144</u> | <u>\$ (168,089)</u> | <u>\$ 69,183</u> |

| | Nine Months Ended June 30, 2014 | | | |
|---|---------------------------------|-------------------|---------------------|-------------------|
| | Interest and dividends | Realized gains | Unrealized gains | Total |
| Nonoperating gains | \$ 33,911 | \$ 98,411 | \$ 99,893 | \$ 232,215 |
| Other changes in unrestricted net assets | - | - | 8,094 | 8,094 |
| Changes in temporarily restricted net assets | 8,554 | 11,386 | 20,611 | 40,551 |
| Changes in permanently restricted net assets | 1 | 336 | 219 | 556 |
| | <u>\$ 42,466</u> | <u>\$110,133</u> | <u>\$ 128,817</u> | <u>\$ 281,416</u> |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

Patient Accounts Receivable

Patient accounts receivable are stated at estimated net realizable value, and collateral is generally not required. Significant concentrations of patient accounts receivable at June 30, 2015 and 2014 include:

| | 2015 | 2014 |
|---|------|------|
| Government-related programs | 34% | 38% |
| Managed care providers, commercial insurers and other payors | 48% | 45% |
| Self-pay patients | 18% | 17% |
| | 100% | 100% |

Receivables from government-related programs (i.e., Medicare and Medicaid) represent the only concentrated group of payors for the System's receivables, and management does not believe that there is any unusual level of collectability risks associated with these government programs. Commercial and managed care receivables consist of receivables from various payors involved in diverse activities and subject to differing economic conditions and do not represent any concentrated collectability risks to the System.

The System maintains allowances for uncollectible accounts for estimated losses resulting from a payor's inability to make payments on accounts. The System assesses the reasonableness of the allowance account based on historical write-offs, cash collections, the aging of the accounts and other economic factors. Accounts are written off when collection efforts have been exhausted. Management continually monitors and adjusts its allowances associated with its receivables.

Premiums Receivable and Premium Revenue

Premium revenue is recognized as income in the period that members are entitled to receive services, as specified by the provisions of the arrangement. Premiums billed or received in advance of the service period are reported as unearned premiums.

Premiums receivable also includes annual settlements under the cost contract established between SWHP and the Centers for Medicare & Medicaid Services. The CMS Medicare Part B (Section 1876) cost plan contract covers Medicare-covered members' medical services allowed under Medicare Part B coverage and contains provisions for risk sharing and reimbursement of allowed costs for which the Health Plan is not at risk. Final reporting of each plan year's total allowed costs is not completed until June 30 of the year following the plan year, at which time an interim settlement of costs due to/from the plan occurs. Part B cost report audits, conducted on a triennial basis, may result in further adjustments to the total allowable costs reported in the current period and may affect the reimbursement to the Health Plan. Prior year settlements under this contract decreased approximately \$19,662,000 for the

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

year ended June 30, 2015 and increased approximately \$3,609,000 for the nine months ended June 30, 2014. At June 30, 2015 and 2014, the settlement amounts receivable from CMS under this contract were \$9,793,000 and \$31,281,000, respectively. Premiums receivable generally are not collateralized.

Significant concentrations of premiums receivable were 94% and 96% from local, state and federal government-related programs at June 30, 2015 and 2014, respectively. Premium revenue from local, state and federal agencies accounted for 68% and 52% of total premium revenue for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively.

Securities Lending Program

The System participates in securities lending transactions with The Northern Trust Company, investment custodian, whereby a portion of its investments is loaned to selected established brokerage firms in return for cash and securities from the brokers as collateral for the investments loaned, usually on a short-term basis of 30 to 60 days. Collateral provided by brokers is maintained at levels approximating 102.0% of the fair value of the securities on loan and is adjusted for daily market fluctuations. Cash collateral received in connection with these loans is invested in a short-term pooled fund maintained by the lending agent. As of June 30, 2014, the fair value of securities on loan was approximately \$177,139,000 and is included in long-term investments in the accompanying combined balance sheet. The cash collateral held for loaned securities was approximately \$180,833,000 as of June 30, 2014, and is included in invested collateral - securities lending program in the accompanying combined balance sheet. The System's obligation to repay the collateral upon settlement of the lending transactions is reported as a payable under securities lending program in the accompanying combined balance sheet. As the System completed its post-merger assimilation activities related to the investment portfolio, this program was suspended in fiscal year 2015. There are no securities on loan at June 30, 2015.

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

Property and Equipment

Property and equipment are stated at cost on the date of purchase or fair value on the date of contribution or business acquisition. Property and equipment and related accumulated depreciation and amortization are summarized below as of June 30, 2015 and 2014 (in thousands):

| | <u>Useful Life</u> | <u>2015</u> | <u>2014</u> |
|---|--------------------|---------------------|---------------------|
| Land | - | \$ 240,280 | \$ 232,300 |
| Buildings and improvements | 5-40 Years | 3,515,886 | 3,163,733 |
| Major movable equipment and other | 3-20 Years | 2,295,249 | 2,332,224 |
| Construction-in-progress | - | <u>427,211</u> | <u>454,293</u> |
| | | 6,478,626 | 6,182,550 |
| Accumulated depreciation and amortization | | <u>(3,106,816)</u> | <u>(2,863,427)</u> |
| | | <u>\$ 3,371,810</u> | <u>\$ 3,319,123</u> |

Property and equipment financed under capital leases totaled approximately \$470,125,000 and \$470,815,000 at June 30, 2015 and 2014, respectively, and related accumulated amortization was approximately \$137,753,000 and \$134,768,000 at June 30, 2015 and 2014, respectively. Amortization expense is included in depreciation and amortization expense in the accompanying combined statements of operations and changes in net assets.

Depreciation and amortization expense is calculated using the straight-line method over the estimated useful lives of the property and equipment or the lease term, whichever is less. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase capacities or extend useful lives are capitalized.

Goodwill and Intangible Assets

Goodwill and intangible assets recorded in connection with acquisitions completed by the System are accounted for under ASC 350, “*Intangibles - Goodwill and Other.*” Goodwill consists of costs in excess of tangible and intangible net assets acquired. Intangible assets consist of management service contract rights and other intangibles.

Goodwill and indefinite-lived intangible assets are tested for impairment annually or more frequently if changing circumstances warrant. No impairments were identified as of June 30, 2015 and 2014.

The System amortizes definite-lived intangible assets over their respective useful lives to the estimated residual values and reviews for impairment in the same manner as long-lived assets discussed below. No impairments were identified in 2015 or 2014.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

At June 30, 2015 and 2014, intangible assets and goodwill consisted of the following (in thousands):

| | 2015 | | |
|--------------------------------------|-----------------------------|-----------------------------|---------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Intangible assets: | | | |
| Definite-lived intangible assets | \$ 14,148 | \$ 10,784 | \$ 3,364 |
| Indefinite-lived intangible assets | <u>13,812</u> | <u>-</u> | <u>13,812</u> |
| Total intangible assets | 27,960 | 10,784 | 17,176 |
| Goodwill | <u>376,200</u> | <u>2,633</u> | <u>373,567</u> |
| Total intangible assets and goodwill | <u>\$ 404,160</u> | <u>\$ 13,417</u> | <u>\$ 390,743</u> |
| | | | |
| | 2014 | | |
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Intangible assets: | | | |
| Definite-lived intangible assets | \$ 7,521 | \$ 314 | \$ 7,207 |
| Indefinite-lived intangible assets | <u>11,734</u> | <u>-</u> | <u>11,734</u> |
| Total intangible assets | 19,255 | 314 | 18,941 |
| Goodwill | <u>343,007</u> | <u>4,043</u> | <u>338,964</u> |
| Total intangible assets and goodwill | <u>\$ 362,262</u> | <u>\$ 4,357</u> | <u>\$ 357,905</u> |

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset, or related groups of assets, may not be recoverable from estimated future cash flows. In the event of impairment, measurement of the amount of impairment may be based on appraisal, fair values of similar assets or estimates of future discounted cash flows resulting from the use and ultimate disposition of the asset. No impairment was identified in 2015 or 2014.

Medical Claims Payable

Medical claims payable represent management’s best estimate of the ultimate net cost of all reported and unreported claims and claim adjustment expenses incurred through June 30, 2015 and 2014. Reserves for unpaid claims are actuarially estimated using individual case-

**BAYLOR SCOTT & WHITE HOLDINGS
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Notes to Combined Financial Statements – continued

basis valuations and statistical analysis. These estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that reserves for unpaid claims are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in operations when determined. There were no material adjustments to these estimates recorded during the year ended June 30, 2015 and the nine months ended June 30, 2014.

A rollforward of medical claims payable for the year ended June 30, 2015 and the nine months ended June 30, 2014, is as follows (in thousands):

| | Year Ended 2015 | Nine Months Ended 2014 |
|--|--------------------|------------------------------|
| Medical claims payable - beginning of period | \$ 21,874 | \$ 21,540 |
| Incurred related to: | | |
| Current year | 272,525 | 176,670 |
| Prior years | <u>(1,652)</u> | <u>297</u> |
| | 270,873 | 176,967 |
| Paid related to: | | |
| Current year | (253,404) | (169,618) |
| Prior years | <u>(11,921)</u> | <u>(7,015)</u> |
| | (265,325) | (176,633) |
| Medical claims payable - end of period | <u>\$ 27,422</u> | <u>\$ 21,874</u> |

Income Taxes

Due to the organizational structure, certain of the System’s entities are taxable under the Internal Revenue Code and some entities are tax exempt but are required to pay income taxes for unrelated business activities. The overall impact of federal income taxes to the System’s combined financial statements is not significant. In addition, certain of the System’s entities file partnership income tax returns in the U.S. federal jurisdiction and franchise tax returns in the State of Texas. These entities are no longer subject to U.S. federal, state and local income tax examinations by authorities for years prior to 2011.

The Texas franchise tax applies to certain of the System’s entities. The tax is calculated on a margin base and is therefore reflected in the System's combined statements of operations and changes in net assets as income tax expense.

The System follows the provisions of ASC 740, “Income Taxes.” As of June 30, 2015 and 2014, the System had no material gross unrecognized tax benefits.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

Insurance

On July 1, 2014, Health Care Insurance Company of Texas, Ltd. (HCICT), a Cayman Islands company whose sole shareholder was BHCS, merged into Scott & White Assurance Ltd. (SWAL), a Cayman Islands company whose sole shareholder, SWMH, was acting by and through its Board of Trustees and in connection with such merger, the shares of HCICT held by BHCS were cancelled. Following the merger (i) SWAL was re-registered as a Cayman Islands segregated portfolio company, (ii) SWAL changed its name to Baylor Scott & White Assurance SPC (BSWA); and (iii) SWMH distributed the shares of BSWA held by it to its sole member SWH, following which SWH distributed such shares to its sole member, following which BSW Holdings contributed such shares to BHCS, following which BHCS contributed such shares to BUMC which, as a result of such transactions, became the sole shareholder of BSWA. Baylor and Scott & White policies were consolidated and rewritten on July 1, 2014.

Baylor provides for the basic self-insured retention limits for hospital professional liability and general liability coverage through the Self Insurance Retention Trust (SIRT). In 2014, excess policies that covered claims that exceeded \$10,000,000 per incident and \$50,000,000 in the aggregate for hospital professional liability and claims that exceeded \$2,000,000 per incident and \$7,000,000 in the aggregate for general liability were provided by HCICT. Baylor provides for the basic self-insured retention limits for professional liability coverage for physicians in HealthTexas Provider Network, a wholly owned subsidiary of BHCS, through the SIRT. In 2014, an excess policy that covered claims for physician liability that exceeded \$750,000 per incident and \$15,000,000 in the aggregate was provided by HCICT and reinsured by ACE Limited for limits of \$250,000 per medical incident and \$7,000,000 in the aggregate. In 2015, excess policies that covered claims that exceeded \$10,000,000 per incident and \$50,000,000 in the general aggregate (shared) for hospital professional liability, general liability and HealthTexas Provider Network professional liability were provided by BSWA. The excess liability policies are reinsured 100% by ACE American Insurance Company and various other reinsurers.

Scott & White self-insures a large amount of its professional liability (malpractice) risk and general liability through its wholly-owned captive BSWA. In addition, in 2014, Scott and White retained a claims-made captive re-insurance program for claims exceeding \$7,000,000 individually or \$35,000,000 in aggregate. In accordance with the policy, Scott and White will pay the first \$7,000,000 of an individual claim, and no more than an aggregate total of \$35,000,000 on all claims in a given year. In addition, SWAL provided excess re-insurance liability to Scott and White in the amount of \$100,000,000. The excess liability policies are reinsured 100% by ACE American Insurance Company and various other reinsurers. In 2015, Scott and White retained a claims-made captive re-insurance program for claims exceeding \$10,000,000 individually or \$50,000,000 in aggregate. In accordance with the policy, Scott and White will pay the first \$10,000,000 of an individual claim, and no more

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

than an aggregate total of \$50,000,000 on all claims in a given year. In addition, BSWA provided excess re-insurance liability to Baylor Scott and White Health in the amount of \$100,000,000. The excess liability policies are reinsured 100% by ACE American Insurance Company and various other reinsurers.

Reserves for Losses and Loss Adjustment Expenses

The reserve for losses and loss adjustment expenses are based upon management's best estimate of the ultimate liability for outstanding losses and loss adjustment expenses determined in comparison with historical and industry loss statistics. Management uses case basis evaluations and actuarial analysis to develop their best estimate. Management believes that the reserves for losses and loss adjustment expenses are adequate. However, because of the extended period of time over which losses are settled and the general uncertainty surrounding the estimates, the ultimate settlement cost of the losses and the related loss adjustment expenses could vary and these differences could be material. The estimate is continuously reviewed and, as adjustments to the liability become necessary, they are reflected in current operations.

Liabilities for outstanding claims, including estimates for claims incurred but not reported, as well as reported claims pending settlement, are actuarially determined and discounted using an interest rate of 2.0% in both 2015 and 2014. Total undiscounted reserves for losses and loss adjustment expenses were approximately \$79,278,000 and \$80,738,000 at June 30, 2015 and 2014, respectively. Discounted reserves for losses and loss adjustment expenses including a risk margin at an approximate seventy percent confidence level were approximately \$80,998,000 and \$82,572,000 at June 30, 2015 and 2014, respectively.

Contributions and Gifts

When received or pledged, unrestricted gifts are reported as contributions to unrestricted net assets, and donor-restricted items are reported as contributions to temporarily or permanently restricted net assets. These donor-restricted contributions are restricted as to use and are transferred from temporarily restricted net assets to unrestricted net assets when the restrictions are satisfied or in the case of endowment funds, when related earnings are appropriated for expenditure.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are donor restricted as to use and are transferred from temporarily restricted net assets to unrestricted net assets when the restrictions are satisfied. Temporarily restricted net assets are primarily available for patient care, medical education, and research.

Permanently restricted net assets include donor restrictions that the principal be invested in perpetuity and only the income from the investments be expended for designated purposes.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

Income on endowment funds restricted for specified purposes is reported in the accompanying combined statements of operations and changes in net assets as temporarily restricted realized gains and investment income and unrealized gains (losses) on investments.

Income on endowment funds which is required by donors to be invested in perpetuity is reported in the accompanying combined statements of operations and changes in net assets as permanently restricted realized gains and investment income and unrealized gains (losses) on investments.

Revenue and Gains in Excess of Expenses and Losses

The combined statements of operations and changes in net assets include revenues and gains in excess of expenses and losses. Other changes in unrestricted net assets which are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include unrealized gains on investments other than trading securities, transactions related to noncontrolling interests, and net assets released from restrictions for capital expenditures.

Derivative Financial Instruments

ASC 815, “*Derivatives and Hedging*,” requires that all derivative financial instruments be recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. Changes in the fair value of derivative financial instruments are recognized periodically in nonoperating gains (losses). The System’s policy is to not hold or issue derivatives for trading purposes and to avoid derivatives with leverage features.

Use of Estimates

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

Reclassifications

Certain reclassifications were made to the 2014 financial statements to conform to the 2015 presentation.

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurements

As defined in ASC 820, “*Fair Value Measurements*”, fair value is based on the prices 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. In order to increase consistency and

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

comparability in fair value measurements, ASC 820 establishes a three-tier fair value hierarchy for disclosure of fair value measurements.

The valuation hierarchy is 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 by market participants for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - Inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability are unobservable and developed based on the best information available in the circumstances.

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.

The carrying values of cash and cash equivalents, THVG funds due from USPI, patient accounts receivable, other receivables, assets held as collateral - securities lending program, investments of insurance subsidiaries, accounts payable, payable under securities lending program, accrued liabilities, and estimated third-party payor settlements payable are reasonable estimates of their fair value due to the short-term nature of these financial instruments.

Fair values of short-term investments and long-term investments are generally 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 are obtained from various sources including market participants, dealers, and brokers. This applies to investments such as domestic equities, U.S. treasuries, exchange-traded mutual funds, and agency securities.

Alternative Investments

Investments held consist of marketable securities as well as securities that do not have readily determinable fair values. Private equity investments, real estate investments and hedge funds are collectively referred to as "alternative investments". These are included in unrestricted long-term investments in the accompanying combined balance sheets, other than those held at

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

BFT. The investments in alternative investments are valued by management at fair value utilizing the net asset value (NAV) provided by the underlying investment companies unless management determines some other valuation is more appropriate. Such fair value estimates do not reflect early redemption penalties as the System does not intend to sell such investments before the expiration of the early redemption periods. The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner and are based on historical cost, appraisals, or other estimates that require varying degrees of judgment. If no public market exists for the investment securities, the fair value is determined by the general partner taking into consideration, among other things, the cost of securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate. As this valuation methodology is based primarily on unobservable inputs, these investments represent Level 3 assets. Any hedge funds valued at NAV which are redeemable by the System at NAV per share (or its equivalent) at the measurement date are transferred from Level 3 assets to Level 2 assets. Any hedge funds valued at NAV that were classified in prior year as Level 2 assets that are not redeemable by the System at NAV per share (or its equivalent) at the measurement date are transferred from Level 2 assets to Level 3 assets.

Included in collective investment funds held at BFT for the BHCS Foundation are alternative investment interests in private equity funds and oil and gas interests. These interests are included in restricted long-term investments in the accompanying combined balance sheets. These alternative investments are in limited partnership interests and are carried at the NAV provided by the underlying investment companies unless management determines some other valuation is more appropriate. As this valuation methodology is based primarily on unobservable inputs, these investments represent Level 3 assets. Also included in Level 3 assets for the BHCS Foundation are other real estate and oil and gas interests which are carried at lower of cost or market.

Beneficial Interest

The System records charitable remainder trusts, where they are not the trustee, at the discounted present value of the estimated future cash flows. These trusts are reported in contributions receivable, net, in the accompanying combined balance sheets. When a third-party serves as trustee, the beneficial interest is required to be measured at fair value on a recurring basis. As beneficial interests utilize multiple unobservable inputs, including no active markets, and are measured using management's assumption about risk inherent in the valuation technique, beneficial interests in split-interest agreements represent Level 3 assets.

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,

**BAYLOR SCOTT & WHITE HOLDINGS
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Notes to Combined Financial Statements – continued

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.

The following tables set forth below, by level, the financial assets and liabilities measured at fair value on a recurring basis at June 30, 2015 and 2014 (in thousands):

| | June 30, 2015 | | | |
|---|------------------|------------------|------------------|----------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash and cash equivalents | | | | |
| Cash | \$1,142,725 | \$1,142,725 | \$ - | \$ - |
| Money market funds | <u>42,560</u> | <u>42,560</u> | - | - |
| Total cash and cash equivalents | <u>1,185,285</u> | <u>1,185,285</u> | - | - |
| Short-term investments | | | | |
| Mutual funds | 41,605 | 41,605 | - | - |
| Certificates of deposit | 1,935 | 1,935 | - | - |
| Fixed income securities | 22,022 | - | 22,022 | - |
| U.S. government securities | 5,268 | 1,419 | 3,849 | - |
| Other | <u>1,042</u> | <u>1,042</u> | - | - |
| Total short-term investments | <u>71,872</u> | <u>46,001</u> | <u>25,871</u> | - |
| Unrestricted long-term investments | | | | |
| Cash | 4,027 | 4,027 | - | - |
| Mutual funds | 3,770 | 3,770 | - | - |
| Equity securities | 1,037,241 | 429,773 | 607,468 | - |
| Fixed income securities | 427,643 | - | 427,643 | - |
| U.S. government securities | 269,095 | 4,680 | 264,415 | - |
| Mortgage-backed securities | 132,593 | 36,859 | 95,734 | - |
| Hedge fund/diversifiers alternative investments | 521,713 | - | 388,200 | 133,513 |
| Private equity alternative investments | 160,212 | - | - | 160,212 |
| Real estate alternative investments | 85,339 | - | - | 85,339 |
| Common funds, held at Baptist Foundation of Texas (BFT) | | | | |
| Group investment fund | 221 | - | 221 | - |
| Group bond fund | 14 | - | 14 | - |
| Group equity fund | 32 | - | 32 | - |
| Other funds | 9 | 5 | - | 4 |
| Other | <u>295</u> | <u>8</u> | <u>19</u> | <u>268</u> |
| Total unrestricted long-term investments | <u>2,642,204</u> | <u>479,122</u> | <u>1,783,746</u> | <u>379,336</u> |

**BAYLOR SCOTT & WHITE HOLDINGS
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Notes to Combined Financial Statements – continued

| | June 30, 2015 | | | |
|---|---------------|-----------|---------|---------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets (continued): | | | | |
| Restricted long-term investments | | | | |
| Cash | \$ 43,544 | \$ 43,544 | \$ - | \$ - |
| Mutual funds | 22,487 | 22,487 | - | - |
| Equity securities | 157,577 | 67,230 | 90,347 | - |
| Fixed income securities | 49,539 | 104 | 49,435 | - |
| U.S. government securities | 31,253 | 1,881 | 29,372 | - |
| Mortgage-backed securities | 14,973 | 4,195 | 10,778 | - |
| Hedge fund/diversifiers alternative investments | 39,640 | - | 29,098 | 10,542 |
| Private equity alternative investments | 22,267 | - | - | 22,267 |
| Real estate alternative investments | 8,692 | - | - | 8,692 |
| Split-interest agreements | 4,767 | - | 4,767 | - |
| Real estate | 850 | - | - | 850 |
| Cash surrender value of life insurance | 1,258 | - | - | 1,258 |
| Common funds, held at Baptist Foundation of Texas (BFT) | | | | |
| Group investment fund | 43,520 | - | 43,520 | - |
| Group bond fund | 2,816 | - | 2,816 | - |
| Group equity fund | 6,222 | - | 6,222 | - |
| Other funds | 1,839 | 1,040 | - | 799 |
| Total restricted long-term investments | 451,244 | 140,481 | 266,355 | 44,408 |
| Assets whose use is limited | | | | |
| Cash | 24,329 | 24,329 | - | - |
| Mutual funds | 97,188 | 97,188 | - | - |
| Equity securities | 31,849 | 22,849 | 9,000 | - |
| Fixed income securities | 32,844 | - | 32,844 | - |
| U.S. governments securities | 12,614 | - | 12,614 | - |
| Mortgage-backed securities | 9,742 | 1,303 | 8,439 | - |
| Other | 159 | 159 | - | - |
| Total assets whose use is limited | 208,725 | 145,828 | 62,897 | - |

**BAYLOR SCOTT & WHITE HOLDINGS
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Notes to Combined Financial Statements – continued

| | June 30, 2015 | | | |
|--|--------------------|--------------------|--------------------|-------------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets (continued): | | | | |
| Contributions receivable, net | | | | |
| Beneficial interest in split-interest agreements | \$ 22,645 | \$ - | \$ - | \$ 22,645 |
| Total contributions receivable, net | 22,645 | - | - | 22,645 |
| Total assets at fair value | <u>\$4,581,975</u> | <u>\$1,996,717</u> | <u>\$2,138,869</u> | <u>\$ 446,389</u> |
| Liabilities: | | | | |
| Interest rate swap agreements, net of collateral | \$ 258,531 | \$ - | \$ 258,531 | \$ - |
| Total liabilities at fair value | <u>\$ 258,531</u> | <u>\$ -</u> | <u>\$ 258,531</u> | <u>\$ -</u> |

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**BAYLOR SCOTT & WHITE HOLDINGS
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Notes to Combined Financial Statements – continued

| | June 30, 2014 | | | |
|---|------------------|----------------|------------------|----------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash and cash equivalents | | | | |
| Cash | \$ 682,414 | \$ 682,414 | \$ - | \$ - |
| Money market funds | <u>61,494</u> | <u>61,494</u> | <u>-</u> | <u>-</u> |
| Total cash and cash equivalents | <u>743,908</u> | <u>743,908</u> | <u>-</u> | <u>-</u> |
| Short-term investments | | | | |
| Mutual funds | 33,957 | 33,957 | - | - |
| Certificates of deposit | 599 | 599 | - | - |
| Fixed income securities | 21,395 | 4 | 21,391 | - |
| U.S. government securities | 15,610 | 760 | 14,850 | - |
| Other | <u>925</u> | <u>925</u> | <u>-</u> | <u>-</u> |
| Total short-term investments | <u>72,486</u> | <u>36,245</u> | <u>36,241</u> | <u>-</u> |
| Invested collateral | <u>180,833</u> | <u>180,833</u> | <u>-</u> | <u>-</u> |
| Unrestricted long-term investments | | | | |
| Cash | 38,623 | 38,623 | - | - |
| Mutual funds | 132,977 | 132,940 | - | 37 |
| Equity securities | 810,448 | 529,746 | 280,702 | - |
| Fixed income securities | 334,749 | - | 334,749 | - |
| U.S. government securities | 163,073 | 3,967 | 159,106 | - |
| Mortgage-backed securities | 146,991 | - | 146,991 | - |
| Hedge fund/diversifiers alternative investments | 397,912 | - | 279,105 | 118,807 |
| Private equity alternative investments | 153,027 | - | - | 153,027 |
| Real estate alternative investments | 77,423 | - | - | 77,423 |
| Municipal bonds | 120 | - | 120 | - |
| Other | <u>4,474</u> | <u>-</u> | <u>4,135</u> | <u>339</u> |
| Total unrestricted long-term investments | <u>2,259,817</u> | <u>705,276</u> | <u>1,204,908</u> | <u>349,633</u> |

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

| | June 30, 2014 | | | |
|---|----------------|----------------|----------------|---------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets (continued): | | | | |
| Restricted long-term investments | | | | |
| Cash | \$ 24,930 | \$ 24,930 | \$ - | \$ - |
| Mutual funds | 85,953 | 85,953 | - | - |
| Equity securities | 122,530 | 86,591 | 35,939 | - |
| Fixed income securities | 55,990 | 125 | 55,865 | - |
| U.S. government securities | 15,567 | 1,125 | 14,442 | - |
| Mortgage-backed securities | 15,846 | - | 15,846 | - |
| Hedge fund/diversifiers alternative investments | 37,036 | - | 27,309 | 9,727 |
| Private equity alternative investments | 30,412 | - | - | 30,412 |
| Real estate alternative investments | 16,827 | - | - | 16,827 |
| Municipal bonds | 82 | - | 82 | - |
| Split-interest agreements | 6,066 | - | 6,066 | - |
| Real estate | 559 | - | - | 559 |
| Cash surrender value of life insurance | 1,243 | - | - | 1,243 |
| Other | 968 | - | 968 | - |
| Common funds, held at Baptist Foundation of Texas (BFT) | | | | |
| Group investment fund | 43,810 | - | 43,810 | - |
| Group bond fund | 2,741 | - | 2,741 | - |
| Group equity fund | 6,155 | - | 6,155 | - |
| Other funds | 2,666 | 1,316 | - | 1,350 |
| Total restricted long-term investments | <u>469,381</u> | <u>200,040</u> | <u>209,223</u> | <u>60,118</u> |
| Assets whose use is limited | | | | |
| Cash | 103,360 | 103,360 | - | - |
| Mutual funds | 62,320 | 62,320 | - | - |
| Equity securities | 21,494 | 13,339 | 8,155 | - |
| Fixed income securities | 38,971 | 6,661 | 32,310 | - |
| U.S. governments securities | 30,913 | - | 30,913 | - |
| Mortgage-backed securities | 13,631 | - | 13,631 | - |
| Other | 199 | - | 199 | - |
| Total assets whose use is limited | <u>270,888</u> | <u>185,680</u> | <u>85,208</u> | <u>-</u> |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

| | June 30, 2014 | | | |
|--|---------------|-------------|-------------|------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets (continued): | | | | |
| Contributions receivable, net | | | | |
| Beneficial interest in split-interest agreements | \$ 17,984 | \$ - | \$ - | \$ 17,984 |
| Total contributions receivable, net | 17,984 | - | - | 17,984 |
| Investments of insurance subsidiary | | | | |
| Cash | 76 | 76 | - | - |
| Fixed income securities | 2,065 | - | 2,065 | - |
| Total investments of insurance subsidiary | 2,141 | 76 | 2,065 | - |
| Total assets at fair value | \$4,017,438 | \$2,052,058 | \$1,537,645 | \$ 427,735 |
| Liabilities: | | | | |
| Interest rate swap agreements, net of collateral | \$ 203,312 | \$ - | \$ 203,312 | \$ - |
| Total liabilities at fair value | \$ 203,312 | \$ - | \$ 203,312 | \$ - |

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BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

The following table is a roll forward of the combined balance sheet amounts for financial instruments classified by the System within Level 3 of the valuation hierarchy defined above for the year ended June 30, 2015 and the nine months ended June 30, 2014 (in thousands):

| | Year Ended June 30, 2015 | | | | | | Common Investment Funds Total |
|--------------------------------|--------------------------|------------------|-------------------|-----------------|------------------------------|-------------------------------|--|
| | Private Equity | Real Estate | Hedge Funds | Other Funds | Split-Interest Agreements | Common Investment Funds | |
| Balance, beginning of period | \$ 183,439 | \$ 94,250 | \$ 128,534 | \$ 2,178 | \$ 17,984 | \$ 1,350 | \$ 427,735 |
| Realized gains (losses), net | 10,712 | 6,274 | (2,463) | - | 632 | - | 15,155 |
| Unrealized (losses) gains, net | (11,947) | 1,899 | 16,693 | 149 | 221 | (318) | 6,697 |
| Purchases | 28,043 | 7,076 | 44,793 | 107 | 5,048 | - | 85,067 |
| Settlements | (27,768) | (15,468) | (1,207) | (58) | (1,240) | (229) | (45,970) |
| Transfers out of Level 3 | - | - | (77,122) | - | - | - | (77,122) |
| Transfers into Level 3 | - | - | 34,827 | - | - | - | 34,827 |
| Balance, end of period | <u>\$ 182,479</u> | <u>\$ 94,031</u> | <u>\$ 144,055</u> | <u>\$ 2,376</u> | <u>\$ 22,645</u> | <u>\$ 803</u> | <u>\$ 446,389</u> |

| | Nine Months Ended June 30, 2014 | | | | | | Common Investment Funds Total |
|--------------------------------|---------------------------------|------------------|-------------------|-----------------|------------------------------|-------------------------------|--|
| | Private Equity | Real Estate | Hedge Funds | Other Funds | Split-Interest Agreements | Common Investment Funds | |
| Balance, beginning of period | \$ 173,146 | \$ 89,186 | \$ 140,724 | \$ 2,091 | \$ 18,263 | \$ 1,633 | \$ 425,043 |
| Realized gains (losses), net | 17,284 | 1,478 | 2,505 | - | (1,469) | - | 19,798 |
| Unrealized gains (losses), net | 12,117 | 6,602 | 32,006 | 82 | 792 | (193) | 51,406 |
| Purchases | 17,675 | 1,622 | 1,982 | 5 | 398 | - | 21,682 |
| Settlements | (36,783) | (4,638) | (5,921) | - | - | (90) | (47,432) |
| Transfers out of Level 3 | - | - | (53,096) | - | - | - | (53,096) |
| Transfers into Level 3 | - | - | 10,334 | - | - | - | 10,334 |
| Balance, end of period | <u>\$ 183,439</u> | <u>\$ 94,250</u> | <u>\$ 128,534</u> | <u>\$ 2,178</u> | <u>\$ 17,984</u> | <u>\$ 1,350</u> | <u>\$ 427,735</u> |

At June 30, 2015 and 2014, alternative investments recorded at net asset value consisted of the following (in thousands):

| | June 30, 2015 | | | |
|---|-------------------|-------------------------|--|--------------------------------|
| | Fair Value | Unfunded Commitments | Redemption Frequency if Currently Eligible | Redemption Notice Period |
| Equity long/short hedge funds ^a | \$ 17,803 | \$ - | quarterly, annually | 60-90 days |
| Event driven investments ^b | 108,853 | - | quarterly, annually | 30-90 days |
| Relative value investments ^c | 88,684 | - | monthly, quarterly | 30-90 days |
| Tactical trading investments ^d | 151,287 | - | daily, monthly | 2-90 days |
| Risk parity ^e | 194,726 | - | monthly | 5-30 days |
| Real estate funds - open ended ^f | 61,760 | - | quarterly | 90 days |
| Real estate funds - close ended ^g | 32,271 | 1,078 | | |
| Group mortgage loan and real estate fund ^h | 368 | - | | |
| Oil and gas funds ⁱ | 381 | - | | |
| Private equity funds ^j | <u>182,479</u> | <u>94,668</u> | | |
| Total | <u>\$ 838,612</u> | <u>\$ 95,746</u> | | |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

| | June 30, 2014 | | | |
|---|---------------|-------------------------|--|--------------------------------|
| | Fair Value | Unfunded Commitments | Redemption Frequency if Currently Eligible | Redemption Notice Period |
| Equity long/short hedge funds ^a | \$ 40,903 | \$ - | quarterly, annually | 60-90 days |
| Event driven investments ^b | 101,863 | 4,842 | quarterly, annually | 30-90 days |
| Relative value investments ^c | 89,834 | - | monthly, quarterly | 30-90 days |
| Tactical trading investments ^d | 47,781 | - | daily, monthly | 2-90 days |
| Risk parity ^e | 154,567 | - | monthly | 5-30 days |
| Real estate funds - open ended ^f | 54,897 | - | quarterly | 90 days |
| Real estate funds - close ended ^g | 39,353 | 809 | | |
| Group mortgage loan and real estate fund ^h | 628 | - | | |
| Oil and gas funds ⁱ | 536 | - | | |
| Private equity funds ^j | 183,439 | 66,171 | | |
| Total | \$ 713,801 | \$ 71,822 | | |

- a) Equity long/short strategy involves managers buying long equities that are expected to increase in value and selling short equities that are expected to decrease in value. Typically, equity long/short investing is based on "bottom up" fundamental analysis of the individual companies, in which investments are made. There may also be "top down" analysis of the risks and opportunities offered by industries, sectors, countries, and the macroeconomic situation. Long/short covers a wide variety of strategies. There are generalists, and managers who focus on certain industries and sectors or certain regions. Managers may specialize in a category - for example, large cap or small cap, value or growth. There are many trading styles, with frequent or dynamic traders and some longer-term investors. Returns are generally more correlated with the direction of the equity markets, although reduction in market risk exposure through shorting is expected to enhance the absolute and risk-adjusted returns relative to the overall performance of the asset class. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- b) Event-driven investing is a strategy which seeks to exploit pricing inefficiencies that may occur before or after a corporate event, such as an earnings call, bankruptcy, merger, acquisition, or spinoff. Returns are less correlated with the general direction of market movements primarily due to the idiosyncratic nature of individual events. Several investment managers include quarterly percentage redemption limits. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- c) Relative value strategies are designed to focus on large, long-term mispricing in the global fixed-income, equity and credit markets, capturing relative-value anomalies via multi-product trades. Returns are relatively uncorrelated with the general direction of market

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

movements since they avoid taking a directional bias with regards to the price movement of a specific stock or market. Several investment managers include quarterly percentage redemption limits and/or early redemption penalties. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.

- d) Tactical trading strategies generally invest on a large scale around the world using economic theory to justify the decision making process on either a discretionary or systematic basis. Strategies are typically based on forecasts and analysis about interest rates trends, the general flow of funds, political changes, government policies, inter-government relations, and other broad systemic and technical factors. Returns are relatively uncorrelated with the general direction of market movements. Several investment managers include quarterly percentage redemption limits. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- e) The risk parity class strategy invests across global markets including equities, nominal government bonds, inflation linked bonds, commodities, and emerging markets on a risk balanced framework. Typically these strategies incorporate leverage to increase the risk contribution from low volatility asset classes (e.g., inflation linked bonds and nominal government bonds). The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- f) The real estate funds - open ended class includes a real estate fund that invests in U.S. commercial real estate. The fair values of the investments in this class have been estimated using the net asset value, which is based on the ownership interest of partners' capital. Redemptions are available on a quarterly basis, subject to the discretion of the General Partners. The General Partners may elect to establish a redemption queue should the level of redemptions for a given quarter be detrimental to the fund's overall performance.
- g) The real estate funds - close ended class includes several real estate funds that invest primarily in U.S. commercial real estate and industries related to real estate, with some having minimal exposure outside of the U.S. The fair values of the investments in this class have been estimated using the net asset value, which is based on the ownership interest of partners' capital. These partnerships are illiquid and therefore do not have a redemption feature. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of these funds will be liquidated over the next six years with the value of those underlying assets being replaced by investments in new real estate funds.
- h) The group mortgage loan and real estate class is primarily invested in real estate and loans secured by real estate located in the Dallas/Fort Worth area. The fair value of the

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

investments have been estimated based on internal appraisals using the fund management's knowledge of the properties, current real estate market for similar properties and recent sales of comparative properties. This fund is illiquid and redemption is subject to fund management approval. Distributions from the fund will be received as the underlying investments are liquidated. It is estimated that the underlying assets of the fund will be liquidated over the next 2 to 10 years. This fund is closed to new investors.

- i) The oil and gas class is primarily invested in mineral properties located in Texas and Wyoming. The fair value of the mineral properties have been estimated by multiplying the most recent twelve months of royalty income, excluding lease bonus income, times a factor of four. The fund's management used a multiple of four for the valuation based on current industry methodology, recent market transactions, and the fund's extensive experience in mineral properties. This fund is illiquid and redemption is subject to fund management approval. Royalty income is distributed quarterly subject to fund management approval (\$0.825 per unit per quarter in 2014 and 2015). Distributions from the fund will be received as the underlying investments are depleted. This fund is closed to new investors.
- j) The private equity class currently includes 35 unique private equity limited partnerships that each invest in a variety of mostly private companies. These investments have a drawdown structure where a portion of commitments (which are made upon entering the partnership) are called gradually over the first 3-6 years of the partnership's life. It is expected that most of the unfunded commitments should be called within the next 6 years. These partnerships are illiquid and therefore do not have a redemption feature. Instead, the nature of the investments in this class is that distributions are received as the investment in the underlying companies are sold. It is estimated that the current underlying assets of these partnerships should be liquidated within the next 10 years. The investments are valued based on each partnership's valuation policy which is then subject to annual third party financial audits. Financial audits are available approximately 90 days following year end. Therefore, the valuation at year end reflects the latest reported manager valuation with adjustments for new capital calls and distributions.

Long-term Debt

The System's long-term debt obligations, excluding capital leases, are reported in the accompanying combined balance sheets at carrying value which totaled approximately \$2,376,592,000 and \$2,097,230,000 at June 30, 2015 and 2014, respectively. The fair value of these obligations is estimated based primarily on quoted market prices for related bonds and is therefore classified as Level 2. The fair value of the System's long-term debt obligations, excluding capital leases totaled approximately \$2,388,594,000 and \$2,203,931,000 at June 30, 2015 and 2014, respectively.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

4. ENDOWMENTS

The System's endowments consist of donor-restricted and board-designated endowment funds for a variety of purposes. The net assets associated with endowment funds are classified and reported based on the existence or absence of donor imposed restrictions.

The System has interpreted the State of Texas Uniform Prudent Management of Institutional Funds Act (UPMIFA) as not requiring the maintaining of purchasing power of permanently restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the System classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the System considers the following factors in making a determination to appropriate or accumulate endowment funds:

- 1) The duration and preservation of the fund
- 2) The purposes of the System and the donor restricted endowment fund
- 3) General economic conditions
- 4) The possible effect of inflation and deflation
- 5) The expected total return from income and the appreciation of investments
- 6) Other resources of the System and
- 7) The investment policies of the System.

Endowment net asset composition by type of fund as of June 30, 2015 and 2014, is as follows (in thousands):

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>2015 Total</u> |
|----------------------------------|---------------------|-----------------------------------|-----------------------------------|-----------------------|
| Donor-restricted endowment funds | \$ 2,184 | \$ 106,438 | \$ 222,218 | \$ 330,840 |
| Board-designated endowment funds | <u>61,139</u> | <u>-</u> | <u>-</u> | <u>61,139</u> |
| Total endowment funds | <u>\$ 63,323</u> | <u>\$ 106,438</u> | <u>\$ 222,218</u> | <u>\$ 391,979</u> |
| | | | | |
| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>2014 Total</u> |
| Donor-restricted endowment funds | \$ 1,162 | \$ 109,662 | \$ 212,809 | \$ 323,633 |
| Board-designated endowment funds | <u>61,507</u> | <u>-</u> | <u>-</u> | <u>61,507</u> |
| Total endowment funds | <u>\$ 62,669</u> | <u>\$ 109,662</u> | <u>\$ 212,809</u> | <u>\$ 385,140</u> |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

Changes in endowment net assets for the year ended June 30, 2015 and the nine months ended June 30, 2014 is as follows (in thousands):

| | Year Ended June 30, 2015 | | | |
|---|--------------------------|-----------------------------------|-----------------------------------|-----------------------|
| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total 2015</u> |
| Endowment net assets, as of June 30, 2014 | \$ 62,669 | \$ 109,662 | \$ 212,809 | \$ 385,140 |
| Investment income and realized gains | 8,115 | 23,959 | 212 | 32,286 |
| Net depreciation and unrealized losses | (5,231) | (15,096) | (93) | (20,420) |
| Gifts | 1,019 | - | 5,806 | 6,825 |
| Appropriation of endowment assets for expenditure | (1,552) | (11,006) | - | (12,558) |
| Other | (1,697) | (1,081) | 3,484 | 706 |
| Endowment net assets, as of June 30, 2015 | <u>\$ 63,323</u> | <u>\$ 106,438</u> | <u>\$ 222,218</u> | <u>\$ 391,979</u> |

| | Nine Months Ended June 30, 2014 | | | |
|---|---------------------------------|-----------------------------------|-----------------------------------|-----------------------|
| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total 2014</u> |
| Endowment net assets, as of September 30, 2013 | \$ 54,573 | \$ 82,344 | \$ 208,240 | \$ 345,157 |
| Investment income and realized gains | 4,296 | 17,323 | 171 | 21,790 |
| Net appreciation and unrealized gains | 3,375 | 19,489 | - | 22,864 |
| Gifts | 656 | 5 | 5,795 | 6,456 |
| Appropriation of endowment assets for expenditure | (866) | (9,882) | (1) | (10,749) |
| Other | 635 | 383 | (1,396) | (378) |
| Endowment net assets, as of June 30, 2014 | <u>\$ 62,669</u> | <u>\$ 109,662</u> | <u>\$ 212,809</u> | <u>\$ 385,140</u> |

Permanently Restricted Net Assets

The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by State of Texas UPMIFA as of June 30, 2015 and 2014 is as follows (in thousands):

| | <u>2015</u> | <u>2014</u> |
|--|-------------------|-------------------|
| Education | \$ 47,180 | \$ 46,739 |
| Patient care | 102,853 | 92,819 |
| Research | 69,986 | 70,025 |
| General operations | 2,199 | 3,226 |
| Total endowment assets classified as permanently restricted net assets | <u>\$ 222,218</u> | <u>\$ 212,809</u> |

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

Endowment Funds with Deficits

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. Deficits of this nature reported in unrestricted net assets were approximately \$0 and \$10,000 as of June 30, 2015 and 2014, respectively. These deficits resulted from unfavorable market fluctuations and authorized appropriation that was deemed prudent.

Endowment Return Objectives and Risk Parameters

The System follows an investment policy that attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return against various indices, based on the endowment's target allocation applied to the appropriate individual benchmarks.

To achieve its long-term rate of return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The System targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

Relationship of Endowment Spending Practices to Investment Objectives

The System determines the appropriation of endowment funds for expenditure reimbursement through the budgeting process. Distribution policies for the System's endowments govern the amount of endowment funds that may be appropriated during this process. In establishing its policies, the System considered the long-term expected return on its endowments. Accordingly, over the long-term, the System expects the current distribution policies to allow its endowments to grow at an average of the long-term rate of inflation and maintain its purchasing power. In order to maintain the purchasing power of endowment assets, expenditures are based on investment performance and spending is curbed in response to deficit situations. Over the long term, the System expects its endowment to grow consistent with its intention to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts.

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

5. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

Long-term debt and capital lease obligations as of June 30, 2015 and 2014, consist of the following:

| | 2015 | 2014 |
|---|----------------|---------|
| | (In thousands) | |
| BSW Holdings - | | |
| Series 2015 Revenue Bonds (Taxable) - | | |
| Term Bonds, fixed interest rate ranging from 2.12% to 4.19%, payable semi-annually, principal payable 2020, 2025 and 2045 | \$ 549,935 | \$ - |
| Series 2015A Revenue Bonds - | | |
| Term Bonds, fixed interest rate of 2.19%, payable semi-annually, principal payable 2016 through 2027 | 176,960 | - |
| BHCS - | | |
| Series 2000 Taxable Notes (Auction Rate Securities) - | | |
| Serial Notes, variable interest (0.19% at June 30, 2015), payable monthly, principal payable 2019 through 2025 | 19,700 | 19,700 |
| Series 2009 Revenue Bonds - | | |
| Serial Bonds, fixed interest rate of 5.00%, payable semi-annually, principal payable through 2019 | - | 12,445 |
| Series 2009 Revenue Bonds - | | |
| Term Bonds, fixed interest rate of 5.75%, payable semi-annually, principal payable 2020 through 2024 | - | 52,555 |
| Series 2009 Revenue Bonds - | | |
| Term Bonds, fixed interest rate of 6.25%, payable semi-annually, principal payable 2025 through 2029 | - | 140,290 |
| Series 2011A Revenue Bonds - | | |
| Term Bonds, fixed interest rate ranging from 2.00% to 5.00%, payable semi-annually, principal payable through 2030 | 79,370 | 95,670 |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

| | <u>2015</u> | <u>2014</u> |
|--|----------------|-------------|
| | (In thousands) | |
| Series 2011B Revenue Bonds - Window Variable Rate Demand Bonds, variable interest (0.27% at June 30, 2015) payable monthly, principal payable 2032 through 2050 | \$ 50,000 | \$ 50,000 |
| Series 2011C, D & E Revenue Bonds - Variable Rate Demand Bonds, variable interest (0.07% at June 30, 2015), payable monthly, principal payable 2032 through 2050 | 134,180 | 135,355 |
| Series 2011F & G Revenue Bonds - Floating Rate Note, variable interest rates (0.82% to 0.80% at June 30, 2015) payable monthly, principal payable 2032 through 2040 | 75,000 | 75,000 |
| Series 2013A Revenue Bonds - Term Bonds, fixed interest rate ranging from 3.38% to 5.00%, payable semi-annually, principal payable 2028 through 2043 | 168,565 | 168,565 |
| Series 2013B Revenue Bonds - Window Variable Rate Demand Bonds, variable interest (0.27% at June 30, 2015) payable monthly, principal payable 2033 through 2050 | 45,000 | 45,000 |
| Series 2013C Revenue Bonds (Taxable) - Term Bonds, fixed interest rate of 4.45%, payable semi-annually, principal payable 2033 through 2043 | 63,045 | 63,045 |
| Term Loan - Variable interest priced every 30 days (1.09% at June 30, 2015) payable quarterly, principal payable 2018 through 2031 | 91,655 | 91,655 |
| Building Lease - Crutcher Annex - Interest of 2.85% payable monthly, principal and interest payments through May 2025 | 11,793 | 12,674 |
| HRT Properties of Texas, Ltd., Building Leases - Interest of 4.88%, payable monthly, principal and interest payments through September 2017 | 6,652 | 9,341 |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

| | <u>2015</u> | <u>2014</u> |
|--|----------------|-------------|
| | (In thousands) | |
| SWH - | | |
| Series 2008A Revenue Bonds - | | |
| Interest at 5.32%, payable semi-annually, principal payable through 2031 | \$ - | \$ 148,770 |
| Series 2008-1 Revenue Bonds - | | |
| Variable rate interest payable monthly (0.06% at June 30, 2015), principal payable 2030 through 2041 | 85,775 | 85,775 |
| Series 2010 Revenue Bonds - | | |
| Term Bonds, fixed interest rate ranging from 4.10% to 5.88%, payable semi-annually, principal payable through 2045 | 270,835 | 339,215 |
| Series 2013A Revenue Bonds - | | |
| Term Bonds, fixed interest rate ranging from 4.50% to 5.00%, payable semi-annually, principal payable through 2043 | 176,690 | 176,690 |
| Series 2013B Revenue Bonds - | | |
| Variable rate interest payable monthly (0.67% at June 30, 2015), principal payable through 2045 | 80,495 | 81,680 |
| Series 2013C Revenue Bonds - | | |
| Variable rate interest payable monthly (0.94% at June 30, 2015), principal payable through 2046 | 94,395 | 94,395 |
| Tax-Exempt Note Payable - variable rate interest (1.27% at June 30, 2015), principal payable through 2017 | 56,225 | 56,225 |
| Note Payable - variable rate interest payable monthly (0.95% at June 30, 2015), principal payable through 2017 | 44,000 | 46,000 |
| Baylor Medical Center at Irving - Building Lease - | | |
| Interest of 3.68% payable monthly, principal and interest payments through March 2045 | 159,523 | 162,457 |
| Texas Heart Hospital of the Southwest, LLP - Denton Building Lease - | | |
| Interest of 5.50%, payable monthly, principal and interest payments through 2030 | 25,000 | 25,000 |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

| | 2015 | 2014 |
|---|----------------|-----------|
| | (In thousands) | |
| BMCC - | | |
| Building Lease - Interest of 9.50%, payable monthly, principal and interest payments through December 2033 | \$ 57,405 | \$ 58,503 |
| Irving-Coppell Surgical Hospital - | | |
| Equipment Notes Payable - Interest ranging from 4.88% to 8.32%, payable monthly, principal and interest payments through January 2015 | - | 557 |
| Texas Health Ventures Group (THVG) - | | |
| Equipment Notes Payable - Interest ranging from 3.00% to 7.00%, payable monthly, principal and interest payments through December 2021 | 37,680 | 24,229 |
| Building Lease, Frisco Medical Center, LLP - Interest at 11.63%, payable monthly, principal and interest payments through June 2027 | 59,196 | 60,381 |
| Building Lease, Arlington Ortho - Interest at 8.61%, payable monthly, principal and interest payments through January 2030 | 22,335 | 22,776 |
| Building Lease, Dallas Uptown - Interest Rate at 9.43%, payable monthly, principal and interest payments through January 2031 | 22,859 | 23,154 |
| Building Lease, Lewisville Surgicare - Interest at 11.39%, payable monthly, principal and interest payments through December 2022 | 4,375 | 4,705 |
| Building Lease, Grapevine Surgicare Partners - Interest at 12.66%, payable monthly, principal and interest payments through October 2021 | 3,337 | 3,623 |
| Other - | | |
| Interest ranging from 1.00% to 13.00%, payable monthly, principal and interest payments through May 2029 | 9,897 | 11,592 |

**BAYLOR SCOTT & WHITE HOLDINGS
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Notes to Combined Financial Statements – continued

| | 2015 | 2014 |
|---|---------------------|---------------------|
| | (In thousands) | |
| Other BSW Holdings Lines of Credit | \$ 63,080 | \$ - |
| Other Scott & White Interim Financing and Lines of Credit | - | 78,080 |
| Other Baylor and Scott & White Capital Leases and Long-Term Debt | 31,891 | 38,243 |
| | 2,776,848 | 2,513,345 |
| Net unamortized original issue premium/discount | 22,293 | 22,164 |
| Current maturities | (61,464) | (138,322) |
| Long-term debt subject to short-term remarketing arrangements | (95,000) | (95,000) |
| | <u>\$ 2,642,677</u> | <u>\$ 2,302,187</u> |

BSW Holdings

On February 21, 2014, BHCS and SWH completed the substitution of each of their existing master trust indentures (the “Old MTIs”) with a new Master Indenture of Trust and Security Agreement, dated February 1, 2014 (the “New MTI”), among BHCS, SWH, and other affiliates from time to time obligated thereunder, and the Bank of New York Mellon Trust Company, National Association, which secures all outstanding notes previously issued by BHCS and SWH under the Old MTIs. At the time of its execution and delivery, the New MTI formed a single obligated credit group consisting of the following entities as Obligated Affiliates: BHCS, SWH, BUMC, Baylor All Saints Medical Center, a Texas nonprofit corporation, Baylor Regional Medical Center at Grapevine, a Texas nonprofit corporation, Baylor Medical Center at Waxahachie, a Texas nonprofit corporation, Baylor Regional Medical Center at Plano, a Texas nonprofit corporation, Scott & White Memorial Hospital, a Texas nonprofit corporation (SWMH), Scott & White Clinic, a Texas nonprofit corporation, Scott & White Hospital – Round Rock, a Texas nonprofit corporation, Scott & White Continuing Care Hospital, a Texas nonprofit corporation, and Hillcrest Baptist Medical Center, a Texas nonprofit corporation.

Effective April 1, 2014, BSW Holdings was admitted as an Obligated Affiliate under the New MTI. In addition, effective April 8, 2014, BSW Holdings was appointed as the Combined Group Representative under the New MTI, replacing BHCS in that role.

In January 2015, BSW Holdings entered into a four-year revolving line of credit with Bank of America, N.A., JP Morgan Chase Bank, N.A., Wells Fargo Bank, N.A., and Citibank, N.A. Under this line of credit, BSW Holdings may borrow at variable rates through January 14, 2019. There was approximately \$63,080,000 of outstanding borrowings as of June 30, 2015. The capacity of the line of credit is \$400,000,000.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

In May and April 2015, respectively, BSW Holdings issued the \$176,960,000 Series 2015A Revenue Bonds and the \$549,935,000 Series 2015 Taxable Revenue Bonds (collectively, the “BSW Holdings 2015 Series”). Proceeds of the BSW Holdings 2015 Series were used to advance refund approximately \$406,595,000 of the outstanding principal of the SWH Series 2008A and BHCS Series 2009 bonds and to partially advance refund the SWH Series 2010 bonds. Upon issuance of the BSW Holdings 2015 Series, \$270,835,000 of the SWH Series 2010 bonds remained outstanding. Remaining proceeds of the Series 2015 Taxable Revenue Bonds were issued to fund development and construction costs of various expansion and construction projects, pay costs of issuance, and provide for any eligible corporate purpose. A loss on extinguishment of debt of approximately \$70,131,000 was recorded related to this transaction.

BHCS

In March 2008, BHCS entered into a three-year taxable revolving line of credit with Bank of America, N.A. and JP Morgan Chase Bank, N.A. In June 2011, this facility was expanded to \$275,000,000 with the addition of two new banks. Under this line of credit, BHCS may borrow at variable rates through January 15, 2015. In June 2014, the facility maturity date was extended from June 13, 2014 to January 15, 2015. There were no outstanding borrowings as of June 30, 2015 and 2014.

In June 2011, BHCS issued \$359,220,000 of Hospital Revenue Bonds through the Tarrant County Cultural Education Facilities Finance Corporation. Proceeds, net of underwriter’s discount, totaling approximately \$364,815,000 were used to repay \$75,000,000 in borrowings under the taxable revolving line of credit and refund \$150,000,000 of Series 2006B and 2006C Revenue Bonds. The remaining bond proceeds were deposited into the fund’s account for costs of issuance and future project expenditures.

The 2011 Window Variable Rate Demand Bonds are subject to long-term amortization periods and may be put to the System at the option of the bondholders in connection with certain remarketing arrangements. To the extent the bondholders may, under the terms of the debt, put their bonds within 12 months after June 30, 2015 and 2014, the principal amount of such bonds has been classified as a current obligation in the accompanying combined balance sheets. Management believes the likelihood of a material amount of bonds being put to the System to be remote. However management has taken steps to provide various sources of liquidity in the event any bonds were to be put back to the System.

In April 2013, BHCS issued \$276,610,000 of Hospital Revenue Bonds, Hospital Refunding Revenue Bonds, and Taxable Hospital Revenue Bonds through the Tarrant County Cultural Education Facilities Finance Corporation. Proceeds net of underwriter’s discount, totaling approximately \$278,753,000 were used to repay \$112,400,000 in borrowings under the taxable revolving line of credit. The remaining bond proceeds were deposited into the fund’s general account for costs of issuance and future project expenditures.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

The 2013 issuance included \$45,000,000 of Window Variable Rate Demand Bonds. These bonds are subject to long-term amortization and may be put to the System at the option of the bondholders in connection with certain remarketing arrangements. To the extent the bondholders may, under the terms of the debt, put their bonds within 12 months after June 30, 2015 and 2014, the principal amount of such bonds has been classified as a current obligation in the accompanying combined balance sheets. Management believes the likelihood of a material amount of bonds being put to the System to be remote. However, management has taken steps to provide various sources of liquidity in the event any bonds are put back to the System.

SWH

In June 2008, SWH issued \$236,395,000 of variable rate demand bonds in three subseries. In October 2010, the Series 2008-3 bonds were refunded with a tax-exempt note in the amount of \$56,225,000. In March 2013, the Series 2008-2 bonds were refunded with the Series 2013C bonds. The direct-pay letters of credit associated with the Series 2008-2 and 2008-3 bonds were terminated at the time of the 2013 refunding. The irrevocable direct-pay letter of credit associated with the Series 2008-1 bonds was replaced in April 2011 and was scheduled to expire on April 11, 2015. The expirations date has been extended to January 16, 2016.

In August 2008, SWH issued the Series 2008A Revenue Bonds with a total par amount of \$172,425,000. Proceeds were used to advance refund the outstanding principal of the Series 2000B and Series 2001 Revenue Bonds and pay costs of issuance of the Series 2008A Revenue Bonds.

In June 2010, SWH issued Series 2010 Revenue Bonds with a total par amount of \$345,775,000. The majority of the proceeds were used to fund development and construction costs of various expansion and construction projects.

In March 2013, SWH issued Series 2013A Revenue Bonds with an aggregate principal of \$176,690,000. Simultaneous to the issuance of its Series 2013A bonds, Scott & White issued Series 2013B Revenue Bonds. The Series 2013B bonds, were issued as direct placement variable rate bonds. Proceeds of the Series 2013B bonds, along with the majority of proceeds for the Series 2013A bonds, were used to advance refund the Series 2006 FHA Revenue Bonds. The remaining portion of the Series 2013A bonds were used to fund development and construction costs of various expansion and construction projects.

In March 2013, SWH issued Series 2013C Revenue Bonds to refinance the Series 2008-2 bonds. Series 2013C bonds were issued as direct placement variable rate bonds.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

Future maturities of long-term debt and capital lease obligations as of June 30, 2015, are shown below (in thousands):

| | <u>Long-Term Debt</u> | <u>Capital Lease Obligations</u> | <u>Total</u> |
|-----------------------|-----------------------|--------------------------------------|---------------------|
| 2016 | \$ 139,269 | \$ 45,410 | \$ 184,679 |
| 2017 | 63,723 | 43,760 | 107,483 |
| 2018 | 39,856 | 40,634 | 80,490 |
| 2019 | 122,279 | 39,427 | 161,706 |
| 2020 | 25,086 | 38,695 | 63,781 |
| Thereafter | <u>1,986,379</u> | <u>505,739</u> | <u>2,492,118</u> |
| | 2,376,592 | 713,665 | 3,090,257 |
| Less imputed interest | <u>-</u> | <u>(313,409)</u> | <u>(313,409)</u> |
| | <u>\$ 2,376,592</u> | <u>\$ 400,256</u> | <u>\$ 2,776,848</u> |

6. INTEREST RATE SWAPS

In February 2013, BHCS suspended the fixed payment and variable receipts under 11 interest rate swaps until January 15, 2016. On January 15, 2016, the swap agreements and respective fixed and variable rate payments will commence between BHCS and its swap counterparties. BHCS is subject to collateral threshold and posting requirements under its swap agreements during the suspension period and after the suspension ends.

At June 30, 2014, a letter of credit, for an amount not to exceed \$50,000,000, was available for collateral support related to the three fixed forward swap agreements outstanding at that date. The counterparty held the undrawn letter of credit, and an actual draw would only be initiated if an event of default or a termination event occurs and is continuing. As of June 30, 2014, no amounts had been drawn on the letter of credit and the letter of credit expired on August 25, 2014.

Effective July 30, 2014, BSWH consolidated its separate International Swaps and Derivatives Association (ISDA) agreements with Goldman Sachs Bank USA (Goldman) and related swap portfolios at BHCS and SWH under a single BSW Holdings ISDA. Upon completion of the BSW Holdings ISDA, BHCS and SWH swaps with Goldman Sachs were novated to the new BSW Holdings ISDA in an aggregate notional amount of \$250,155,000.

Effective August 29, 2014, SWH novated a portion (cash flows through August 15, 2022) of two swaps with JP Morgan to Wells Fargo. The residual remaining cash flows (from September 15, 2022 through August 15, 2045) remain at JP Morgan.

Effective October 23, 2014, BHCS novated the two SWH swaps with Wells Fargo (originally novated from JP Morgan to Wells Fargo on August 29, 2014) from the SWH ISDA to the

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

BHCS ISDA. Concurrent with this novation, the Wells Fargo collateral thresholds under the BHCS Credit Support Annex were increased to accommodate the novated swaps.

At June 30, 2015, BSW Holdings, SWH and BHCS (collectively, the “BSWH Swap Entities”) had twenty-one interest rate swap agreements with a total notional amount of \$1,031,540,000 comprised of \$250,155,000 in notional fixed payer swaps held by BSW Holdings, \$420,310,000 in notional fixed payer swaps held by BHCS and \$361,075,000 in notional fixed receiver and fixed payer swaps held by SWH.

Net settlement payments on interest rate swap agreements totaled \$14,025,000 and \$9,719,000 for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively. Net settlement payments and the change in fair value on interest rate swap agreements are reported in interest rate swap activity in the nonoperating section of the consolidated statements of operations. The fair value of interest rate swap agreements is reported in long-term liabilities on the combined balance sheets. The change in the fair value of interest rate swap agreements was an unrealized loss of approximately \$55,219,000 and \$40,415,000 for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively, and is included as a line item on the combined statements of cash flows.

The following table summarizes the fair value of interest rate swaps by counterparty as of June 30, 2015 and 2014 (in thousands):

| | Notional* <u>Amount</u> | Fair Value | |
|---|----------------------------|---------------------|---------------------|
| | | <u>2015</u> | <u>2014</u> |
| Bank of America, N.A. | \$ 73,740 | \$ (22,941) | \$ (16,294) |
| Deutsche Bank AG | 188,510 | (56,424) | (43,243) |
| Goldman Sachs Bank, USA | 250,155 | (77,033) | (58,041) |
| JP Morgan | 219,075 | (24,296) | (52,700) |
| Wells Fargo Bank, N.A. | <u>300,060</u> | <u>(77,837)</u> | <u>(33,034)</u> |
| Total interest rate swap liability, net | <u>\$ 1,031,540</u> | <u>\$ (258,531)</u> | <u>\$ (203,312)</u> |

*Notional Amount is the face value of a financial instrument used in the calculation of interest.

7. NET PATIENT CARE REVENUE

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per case, reimbursed costs, discounted charges, and per diem payments. Net patient care revenue (exclusive of charity care - see Note 8) is recognized at the time service is rendered and is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated contractual adjustments under reimbursement agreements with third-party payors.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

Contractual adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. These contractual adjustments are related to the Medicare and Medicaid programs and managed care contracts. The System offers a discount to uninsured patients.

Net patient care revenue from the Medicare and Medicaid programs accounted for approximately 35% and 33% of total net patient care revenue for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively. Net patient care revenue from managed care contracts accounted for approximately 60% and 55% of total net patient care revenue for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively. Net patient care revenue from other payors accounted for approximately 5% and 12% of total net patient care revenue for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively.

Federal Regulations require the submission of annual cost reports covering medical costs and expenses associated with services provided to program beneficiaries. Medicare and Medicaid cost report settlements are estimated in the period services are provided to beneficiaries. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimates may change by a material amount as interpretations are clarified and cost reports are settled.

These initial estimates are revised as needed until the final cost report is settled. Net patient care revenue from the Medicare and Medicaid programs increased approximately \$46,920,000 and \$23,303,000 for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively, due to changes in allowances previously estimated for amounts due to Medicare and Medicaid, as a result of changes in regulations and final settlement of numerous cost reports.

Baylor

During the twelve months ended 2015 and the nine months ended 2014, certain Baylor Scott & White Health hospitals (from the legacy Baylor Health Care System) participated in the Medicaid Section 1115 waiver program entitled “Texas Healthcare Transformation and Quality Improvement Program” (“Waiver Program”). The Waiver Program provides for two pools of Medicaid supplemental funding (an uncompensated care pool and a delivery system reform incentive pool).

BHCS (on behalf of Baylor University Medical Center, Baylor Medical Center at Irving, Baylor Medical Centers at Garland and McKinney (d/b/a Baylor Medical Center at Garland), Baylor Specialty Health Centers (d/b/a Our Children’s House at Baylor), Baylor Specialty Health Centers (d/b/a Baylor Specialty Hospital), and Baylor Medical Center at Carrollton) and Baylor Heart and Vascular Center LLP are parties to the Dallas and Neighboring

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

Counties Indigent Care Affiliation Agreement and under this agreement participate in the Waiver Program. After June 30, 2014, management made the decision to withdraw Baylor Specialty Health Centers (d/b/a Baylor Specialty Hospital) from the Dallas and Neighboring Counties Indigent Care Affiliation Agreement effective September 30, 2014.

Baylor All Saints Medical Center, Baylor Regional Medical Center at Grapevine, and Baylor Medical Center at Waxahachie are parties to the Tarrant County Indigent Care Affiliation Agreement and under this agreement participate in the Waiver Program.

Baylor All Saints Medical Center was a party to the Somervell County Indigent Care Affiliation Agreement and under this agreement participated in the Waiver Program. Effective midnight, September 30, 2014, Baylor All Saints Medical Center withdrew from the Somervell County Indigent Care Affiliation Agreement, which withdrawal resulted in simultaneous termination of this agreement.

Baylor Medical Center at Waxahachie was a party to the Ellis County Indigent Care Affiliation Agreement and under this agreement participated in the Waiver Program. Effective midnight December 31, 2014, Baylor Medical Center at Waxahachie withdrew from the Ellis County Indigent Care Affiliation Agreement.

As recipients of Waiver Program payments, these Baylor hospitals are subject to extensive federal and State laws, regulations, conditions of participation, and certification requirements.

For the twelve months ended 2015 and the nine months ended 2014, Baylor Scott & White Health (from the legacy Baylor Health Care System) hospitals received Waiver Program payments (including Delivery System Reform Incentive Payment (“DSRIP”) and Uncompensated Care (“UC”) funds) totaling approximately \$143,993,000 and \$112,238,000, respectively, which amounts are recognized as net patient care revenue. Any anticipated additional amounts are recorded as other receivables in the accompanying balance sheets.

Baylor Scott & White Health hospitals in North Texas also voluntarily participate in indigent care corporations (established by the Baylor hospitals and other private hospitals) in order to improve access to healthcare for Medicaid beneficiaries and other indigent patients. These non-profit, indigent care corporations arrange for the provision of physician and other practitioner professional services to Medicaid beneficiaries and other indigent patients under certain services agreements, with the compensation set in advance, consistent with fair market value, and commercially reasonable for the services performed. For the twelve months ended June 30, 2015 and the nine months ended June 30, 2014, Baylor Scott & White Health hospitals provided approximately \$72,611,000 and \$48,583,000, respectively, to indigent care corporations for professional and other services performed to and for the benefit of patients under the various services agreements, which amounts are recorded as other operating expenses in the combined statements of operations and changes in net assets.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

In a letter dated September 30, 2014 to the Texas Health and Human Services Commission (“THHSC”), the Centers for Medicare & Medicaid Services (“CMS”) announced that it was deferring the federal share (Federal Financial Participation (“FFP”)) of Waiver Program uncompensated care payments to hospitals that are parties to indigent care affiliation agreements in certain counties, including Dallas County and Tarrant County. The initial total amount of the deferral was \$74,891,536 in FFP for Waiver Program uncompensated care payments made during the third quarter of federal fiscal year 2014 to private hospitals in Dallas, Tarrant, and Nueces Counties (\$47,403,926 for private hospitals in Dallas and Tarrant Counties only). Baylor hospitals subject to the deferral were BHCS (on behalf of Baylor University Medical Center, Baylor Medical Center at Irving, Baylor Medical Centers at Garland and McKinney (d/b/a Baylor Medical Center at Garland), Baylor Specialty Health Centers (d/b/a Our Children’s House at Baylor), Baylor Medical Center at Carrollton, Baylor Heart and Vascular Hospital, Baylor All Saints Medical Center, and Baylor Regional Medical Center at Grapevine. CMS indicated that the deferral amount may increase and even include delivery system reform incentive pool payments if the agency would identify other funding arrangements that it believes do not comply with applicable federal and/or State requirements. If CMS and THHSC would not resolve the deferral, CMS would issue a disallowance notice. THHSC could request reconsideration of any CMS disallowance determination by appealing to the Department of Health & Human Services’ Departmental Appeals Board. THHSC and CMS have reached an understanding resulting in a lifting of the deferral and allowing for the continuation of existing payment protocols for payments made through September 2017, unless CMS would find during its continuing review of the indigent care affiliation arrangements violations of the federal statutory or regulatory provider donation prohibitions or breach of State Constitution, statutory, or regulatory requirements or provider certifications. THHSC has filed a Waiver extension with CMS.

Scott & White

During the twelve months ended 2015 and the nine months ended 2014, certain Baylor Scott & White Health hospitals (from the legacy Scott & White Healthcare) participated in the Medicaid Section 1115 waiver program entitled “Texas Healthcare Transformation and Quality Improvement Program” (“Waiver Program”). The Waiver Program provides for two pools of Medicaid supplemental funding (an uncompensated care pool and a delivery system reform incentive pool).

Scott & White Memorial Hospital, is a party to the Bell County Healthcare Collaborative and under this agreement participates in the Waiver Program.

Hillcrest Baptist Medical Center is a party to the McLennan Area Clinical Services Affiliation and under this agreement participates in the Waiver Program.

Round Rock Hospital is a party to the Williamson County and Cities Services Affiliation and under this agreement participates in the Waiver Program.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

Brenham Hospital is a party to the Washington County Affiliation and under this agreement participates in the Waiver Program.

Scott & White Memorial Hospital and Baylor Scott & White Health – Hillcrest Medical Center are participants in Local Provider Participation Funds (“LPPF” or “LPPFs”) in Bell and McLennan Counties respectively. The funds are administered by the counties and all hospital providers in each jurisdiction are subject to an assessment of fees to fund the LPPF. Funds collected are then used to make intergovernmental transfers (“IGT”) to provide the State share of UC payments. The LPPFs were first used to fund UC for Demonstration Year (“DY”) 3.

As recipients of Waiver Program payments, these Scott & White hospitals are subject to extensive federal and State laws, regulations, conditions of participation, and certification requirements.

For the twelve months ended 2015 and the nine months ended 2014, Baylor Scott & White Health hospitals in Central Texas recognized Waiver Program payments (including DSRIP and UC legacy funded and LPPF funded) totaling approximately \$135,447,000 and \$14,529,000, respectively, which amounts are recognized as net patient care revenue. Any anticipated additional amounts are recorded as other receivables in the accompanying balance sheets.

Baylor Scott & White Health hospitals in Central Texas also voluntarily participate in nonprofit corporations (established by the Scott & White hospitals and other private hospitals) in order to improve access to healthcare for Medicaid beneficiaries and other indigent patients. These nonprofit corporations arrange for the provision of physician and other practitioner professional services to Medicaid beneficiaries and other indigent patients under certain services agreements, with compensation set in advance, consistent with fair market value, and commercially reasonable for the services performed. Local assessments were also made to fund the LPPFs. In addition to the LPPF assessments, the providers in each community make or receive community benefit payments in order to stabilize the funding within the community. The total payments related to these programs were \$66,612,000 and \$4,732,000, respectively, and are included in other operating expenses in the combined statements of operations and changes in net assets.

In a letter dated September 30, 2014 to the Texas Health and Human Services Commission (“THHSC”), the Centers for Medicare & Medicaid Services (“CMS”) announced that it was deferring the federal share (Federal Financial Participation (“FFP”)) of Waiver Program uncompensated care payments to hospitals that are parties to indigent care affiliation agreements in certain counties. While Scott & White Hospital – Llano and Scott & White Hospital – Round Rock were included in CMS’s original deferral list of private hospitals, THHSC reported that these hospitals were erroneously included and were removed from the

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

deferral list. CMS reserved the right to include other hospitals and affiliation agreements in the deferral process. THHSC and CMS have reached an understanding that lifts the deferral and allows for the continuation of existing payment protocols for payments made through September 2017, unless CMS would find during its continuing review of the indigent care affiliation arrangements violations of the federal statutory or regulatory provider donation prohibitions or breach of State Constitution, statutory, or regulatory requirements or provider certifications. THHSC has filed a Waiver extension with CMS.

8. CHARITY CARE

The System provides care to patients who lack financial resources and are deemed medically or financially indigent. Because the System does not pursue collection of amounts determined to qualify as charity care, these amounts have been removed from net patient care revenue as described in Note 7. The gross patient charges related to this care along with estimates for possible future charity care write-offs related to current accounts receivable totaled approximately \$701,911,000 and \$590,518,000 for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively. The estimated direct and indirect cost of providing these services, calculated using the ratio of patient care cost to charges, was approximately \$201,885,000 and \$176,541,000 for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively. The ratio of cost to charges is calculated based on total expenses, less non-patient care activities and other community benefit expenses, divided by gross patient services revenue. In addition, the System provides services through government-sponsored indigent health care programs (such as Medicaid) to other indigent patients.

The System also commits time and resources to endeavors and critical services which meet otherwise unfulfilled community needs. Many of these activities are entered into with the understanding that they will not be self-supporting or financially viable. The expenditures for medical research activities and direct medical education are reported in Note 10.

9. RETIREMENT BENEFITS

ASC 715, “*Compensation - Retirement Benefits*,” requires the System to recognize the funded status (i.e., the difference between the fair value of plan assets and the benefit obligation) of its defined benefit pension and other postretirement benefit plans in the accompanying combined balance sheets with a corresponding adjustment to unrestricted net assets. The net unrecognized actuarial losses and unrecognized prior service benefits are recognized as a component of future net periodic cost pursuant to the System’s policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods are recognized as other changes in unrestricted net assets. Those amounts are recognized as a component of net periodic cost.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

The System provides 401(k) defined contribution plans for eligible employees. Employees are eligible to contribute to the plan immediately with no minimum service or age requirement.

The System’s contributions to the 401 (k) plan totaled approximately \$86,333,000 and \$74,791,000 for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively, and are included in salaries, wages, and employee benefits expenses in the accompanying combined statements of operations and changes in net assets.

BHCS and six of its affiliated hospitals provided a defined benefit plan, the Baylor Health Care System Retirement Security Plan (the “BEST Plan”), for employees, which was discontinued on January 1, 1984. All BEST Plan assets were invested in cash and cash equivalents at June 30, 2015 and 2014.

The following table sets forth the benefit obligations, plan assets and funded status of the BEST Plan as of June 30, 2015 and 2014 (in thousands):

| | <u>2015</u> | <u>2014</u> |
|-----------------------------|-------------------|-------------------|
| Fair value of plan assets | \$ 256 | \$ 81 |
| Benefit obligation | <u>(23,102)</u> | <u>(21,075)</u> |
| Unfunded benefit obligation | <u>\$(22,846)</u> | <u>\$(20,994)</u> |

All Saints Health System provided a defined benefit plan, the All Saints Health System Pension Plan (the "All Saints Plan"), for employees of All Saints, which was frozen to future benefit accruals as of January 1, 2002, with the All Saints Health System purchase by BHCS.

The All Saints Plan assets were invested in cash and cash equivalents and equity securities at June 30, 2015 and 2014.

The following table sets forth the benefit obligations, plan assets and funded status of the All Saints Plan as of June 30, 2015 and 2014 (in thousands):

| | <u>2015</u> | <u>2014</u> |
|-----------------------------|------------------|------------------|
| Fair value of plan assets | \$ 19,930 | \$ 20,783 |
| Benefit obligation | <u>(27,664)</u> | <u>(25,885)</u> |
| Unfunded benefit obligation | <u>\$(7,734)</u> | <u>\$(5,102)</u> |

King’s Daughter Hospital provided a defined benefit plan, the Texas Hospital Association Retirement Plan for King’s Daughters (the “King’s Daughters Plan”), for employees of King’s Daughters Hospital, which was frozen to future benefit accruals as of March 31, 2009, with the King’s Daughters Hospital purchase by Scott & White.

**BAYLOR SCOTT & WHITE HOLDINGS
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Notes to Combined Financial Statements – continued

The following table sets forth the benefit obligations plan assets and funded status of the King’s Daughters Plan as of June 30, 2015 and 2014 (in thousands):

| | 2015 | 2014 |
|-----------------------------|------------|------------|
| Fair value of plan assets | \$ 27,074 | \$ 26,727 |
| Benefit obligation | (33,721) | (31,392) |
| Unfunded benefit obligation | \$ (6,647) | \$ (4,665) |

Scott & White Hospital-Brenham provided a defined benefit plan, the Texas Hospital Association Defined Benefit Retirement Plan for Scott & White Hospital-Brenham (the “Brenham Plan”), for employees of Scott & White Hospital-Brenham, which was frozen to future benefit accruals as of June 30, 2010, with the Brenham Hospital purchase by Scott & White.

The following table sets forth the benefit obligations plan assets and funded status of the Brenham Plan as of June 30, 2015 and 2014 (in thousands):

| | 2015 | 2014 |
|-----------------------------|------------|------------|
| Fair value of plan assets | \$ 22,588 | \$ 22,103 |
| Benefit obligation | (26,938) | (24,906) |
| Unfunded benefit obligation | \$ (4,350) | \$ (2,803) |

Certain Scott & White employees participate in Scott & White’s medical postretirement benefit plan. This plan provides medical and dental benefits to retirees who meet specific eligibility requirements upon retirement. The plan is unfunded and requires covered retirees to contribute a portion of the cost of benefits based on age at retirement and years of service.

Scott & White uses an incremental cost approach in estimating the annual accrued cost related to the postretirement benefit plan, which is based on estimates by independent actuaries. Such an approach is considered appropriate since substantially all of the health care benefits are provided by Scott & White to retirees, using the Health Plan to manage the care provided.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 introduced a prescription drug benefit under Medicare (Medicare Part D), as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Scott & White has not made the determination that the prescription drug benefit provided by its medical postretirement benefit plan is actuarially equivalent to the benefit provided by Medicare Part D. Therefore, the measures of the accumulated benefit obligation or net periodic benefit cost do not reflect any amounts associated with the federal subsidy.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

The following section sets forth a reconciliation of benefit obligations, plan assets, and balance sheet position for the postretirement benefit obligation as of June 30, 2015 and 2014 (in thousands):

| | 2015 | 2014 |
|-----------------------------|-------------|-------------|
| Fair value of plan assets | \$ - | \$ - |
| Benefit obligation | (17,490) | (12,306) |
| Unfunded benefit obligation | \$ (17,490) | \$ (12,306) |

10. FUNCTIONAL EXPENSES

The System provides general health care services to residents within its geographic area. Expenses related to providing these services are as follows for the year ended June 30, 2015 and the nine months ended June 30, 2014 (in thousands):

| | Year Ended 2015 | Nine Months Ended 2014 |
|----------------------------|--------------------|------------------------------|
| Patient care | \$ 5,113,102 | \$ 3,520,876 |
| Education | 80,318 | 59,365 |
| Research | 56,202 | 46,149 |
| Health Plan | 393,878 | 282,256 |
| General and administrative | 1,098,308 | 860,245 |
| Other | 121,787 | 76,703 |
| | \$ 6,863,595 | \$ 4,845,594 |

Other includes expenses related to the System’s construction activities, professional office building management, and fundraising.

11. COMMITMENTS AND CONTINGENCIES

BSWH

The System leases various equipment and property under operating leases. These payments are due monthly through December 2035. Future minimum lease commitments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are as follows as of June 30, 2015 (in thousands):

| | |
|------------|------------|
| 2016 | \$ 127,457 |
| 2017 | 118,366 |
| 2018 | 107,618 |
| 2019 | 96,072 |
| 2020 | 86,056 |
| Thereafter | 435,196 |
| | \$ 970,765 |

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

The System has incurred rental expense for both cancelable and noncancelable equipment and space leases totaling approximately \$166,735,000 and \$111,238,000 for the year ended June 30, 2015 and the nine months ended June 30, 2014, respectively.

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, physician ownership and self-referral, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the System is in compliance with applicable fraud and abuse laws and regulations as well as other applicable federal and state laws and regulations.

Irving

The Irving Hospital Authority (“Authority”) entered into a Master Agreement (“Master Agreement”) with Baylor Medical Center at Irving (Irving) and BHCS and a Lease Agreement (“Lease Agreement”) with Irving.

Under the terms of the Lease Agreement, Irving agreed to manage and lease substantially all properties of the Authority over an initial lease term of twenty years, beginning August 1, 1995, with an option to renew the lease for two additional ten year terms. An Amended and Restated Lease Agreement (“Amended Lease Agreement”) was entered into by the Authority and Irving effective April 1, 2010, to extend the lease thirty five years through March 31, 2045, and to supersede nearly all the obligations of the original Master Agreement and Lease Agreement.

The Amended Lease Agreement is accounted for as a capital lease with (a) fixed rent payments of approximately \$8,825,000 per year, as adjusted by a September 24, 2010 amendment to the Amended Lease Agreement, plus (b) a contingent rent payment equal to 20.0% of the excess operating cash flow derived from the prior fiscal year’s operations, as defined in the Amended Lease Agreement. Irving accrued \$7,062,000 and \$2,596,000 at June 30, 2015 and 2014, respectively, for the contingent rent payment due to the Authority within five business days following the issuance of Irving’s audited statements of operations and changes in net assets.

BHCS signed a Limited Joinder to evidence its agreement with the BHCS obligations included in the Amended Lease Agreement and to covenant that BHCS will pay the rent and the early termination fee/liquidated damages if Irving fails to pay those obligations. During

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

the initial six year term of the Revised Lease Agreement, Irving pays BHCS a management fee, based on a percentage of the excess operating cash flow, as defined in the Revised Lease Agreement. BHCS continues to be required to contribute \$100,000 per year to Irving, to be matched by the Irving Healthcare Foundation, for community health projects, which are mutually agreed upon by BHCS and Irving. BHCS contributed \$100,000 directly to Irving in 2015 and 2014. At the end of the lease term the leased facilities will be surrendered to the Authority. At June 30, 2015 and 2014, no liability under the Revised Lease Agreement was recorded as no amount can be reasonably estimated.

Affiliation Agreements

On November 1, 2006, BHCS entered into a five-year affiliation agreement (that automatically renews for additional five year-terms) with Hopkins County Hospital District d/b/a Hopkins County Memorial Hospital, located in Sulphur Springs, Texas (approximately 79 miles northwest of Dallas). The hospital services are also supported locally by an independent Hopkins Memorial Health Care Foundation. Under the affiliation agreement, BHCS provides certain services for a fee which include group purchasing organization sponsorship, advisory services, physician recruitment and access to continuing education programs. Hopkins County Hospital District is not owned or controlled by any member of the System.

On February 1, 2007, BHCS entered into a five-year affiliation agreement (that automatically renews for additional five-year terms) with 99-bed Decatur Hospital Authority d/b/a Wise Regional Health System, located in Decatur, Texas (approximately 40 miles northwest of Fort Worth). Under the affiliation agreement, BHCS provides certain services for a fee which include advisory services, physician recruitment and access to continuing education programs. Decatur Hospital Authority is not owned or controlled by any member of the System.

On October 1, 2008, BHCS entered into a five-year affiliation agreement (that automatically renews for additional five-year terms) with Glen Rose Medical Foundation d/b/a Glen Rose Medical Center, a 16-bed hospital located in Glen Rose, Texas (approximately 54 miles southwest of Fort Worth). As of March 24, 2010, the agreement was assigned to Somervell County Hospital Authority, which assumed operation of the hospital. Under the affiliation agreement, BHCS provides certain services for a fee which include group purchasing organization sponsorship, advisory services, physician recruitment and access to continuing education programs. Somervell County Hospital Authority is not owned or controlled by any member of the System.

On January 1, 2009, BHCS entered into a five-year affiliation agreement (that automatically renews for additional five-year terms) with Hunt Memorial Hospital District, which operates Hunt Regional Medical Center at Greenville located approximately 45 miles northeast of Dallas and is a 201-bed acute care hospital. Under the affiliation agreement, both

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements – continued

organizations remain independent, but BHCS provides certain services for a fee including group purchasing organization sponsorship, advisory services, physician recruitment and access to continuing education programs. Hunt Memorial Hospital District is not owned or controlled by any member of the System.

On July 25, 2012, Baylor Heart and Vascular Hospital (BHVH) entered into a three-year affiliation agreement (that automatically renews for additional one-year terms) with Hunt Memorial Hospital District. Under the affiliation agreement, both organizations remain independent, but BHVH provides catherization lab management for a fee. Hunt Memorial Hospital District is not owned or controlled by any member of the System.

On December 17, 2013, BHCS entered into a five-year affiliation agreement (that automatically renews for additional five-year terms) with Essent PRMC LP d/b/a Paris Regional Medical Center. Paris Regional Medical Center is a 360-bed hospital located in Paris, Texas (approximately 105 miles northeast of Dallas). Under the affiliation agreement, both organizations remain independent, but BHCS provides certain services for a fee including advisory services, physician recruitment and access to continuing education programs. Paris Regional Medical Center is not owned or controlled by any member of the System.

12. NONCONTROLLING INTERESTS

The System controls and therefore consolidates certain investees of its subsidiaries. The System regularly engages in the purchase and sale of noncontrolling interests in these investees that do not result in a change of control. These transactions are accounted for as equity transactions as they are undertaken among the System, its consolidated subsidiaries, and noncontrolling interests, and their cash flow effect is classified within financing activities. The System reflects noncontrolling interests in subsidiaries as either noncontrolling interests - redeemable in the mezzanine section of the accompanying combined balance sheets, or noncontrolling interests - nonredeemable in net assets in the combined balance sheets, according to ASC 810.

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

The activity for unrestricted net assets presented as attributable to the System and noncontrolling interest - nonredeemable for the year ended June 30, 2015 and the nine months ended June 30, 2014 are summarized below (in thousands):

| | <u>Attributable to the System</u> | <u>Noncontrolling Interests - Nonredeemable</u> | <u>Total Unrestricted Net Assets</u> |
|--|---------------------------------------|---|--|
| Balances, as of September 30, 2013 | \$ 3,674,735 | \$ 122,759 | \$ 3,797,494 |
| Revenue and gains in excess of expenses and losses | 412,576 | 35,024 | 447,600 |
| Unrealized gains on investments, net | 8,094 | - | 8,094 |
| Net assets released from restrictions for capital expenditures | 27,531 | - | 27,531 |
| Distributions to noncontrolling interests | - | (33,218) | (33,218) |
| Purchases of noncontrolling interests | - | (1,622) | (1,622) |
| Sales of noncontrolling interests | - | 5,593 | 5,593 |
| Other changes in controlling interest | (1,666) | - | (1,666) |
| Revenue and gains in excess of expenses and losses attributable to noncontrolling interests - redeemable | (125,707) | - | (125,707) |
| Other | <u>(244)</u> | <u>-</u> | <u>(244)</u> |
| Change in unrestricted net assets | <u>320,584</u> | <u>5,777</u> | <u>326,361</u> |
| Balances, as of June 30, 2014 | 3,995,319 | 128,536 | 4,123,855 |
| Revenue and gains in excess of expenses and losses | 531,680 | 47,867 | 579,547 |
| Unrealized gains on investments, net | 5,006 | 165 | 5,171 |
| Net assets released from restrictions for capital expenditures | 7,012 | - | 7,012 |
| Distributions to noncontrolling interests | - | (44,998) | (44,998) |
| Purchases of noncontrolling interests | - | (1,863) | (1,863) |
| Sales of noncontrolling interests | - | 11,920 | 11,920 |
| Other changes in controlling interest | (833) | - | (833) |
| Revenue and gains in excess of expenses and losses attributable to noncontrolling interests - redeemable | (196,964) | - | (196,964) |
| Other | <u>(15,153)</u> | <u>-</u> | <u>(15,153)</u> |
| Change in unrestricted net assets | <u>330,748</u> | <u>13,091</u> | <u>343,839</u> |
| Balances, as of June 30, 2015 | <u>\$ 4,326,067</u> | <u>\$ 141,627</u> | <u>\$ 4,467,694</u> |

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

The activity for noncontrolling interests - redeemable for the year ended June 30, 2015 and the nine months ended June 30, 2014 is summarized below (in thousands):

| | |
|--|-------------------|
| Balance, as of September 30, 2013 | \$ 246,648 |
| Net income attributable to noncontrolling interests - redeemable | 125,707 |
| Distributions to noncontrolling interests | (118,682) |
| Purchases of noncontrolling interests | (6,217) |
| Sales of noncontrolling interests | 26,900 |
| Noncontrolling interest of acquired entities | <u>6,804</u> |
| Balance, as of June 30, 2014 | 281,160 |
| Net income attributable to noncontrolling interests - redeemable | 196,964 |
| Distributions to noncontrolling interests | (182,876) |
| Purchases of noncontrolling interests | (7,334) |
| Sales of noncontrolling interests | 12,755 |
| Noncontrolling interest of acquired entities | <u>12,336</u> |
| Balance, as of June 30, 2015 | <u>\$ 313,005</u> |

13. SUBSEQUENT EVENTS

Baylor Scott & White Assurance SPC - Loss Portfolio Transfer

Effective July 1, 2015, the primary healthcare professional and general liability, physician professional liability, workers compensation and directors' and officers' coverage provided by SIRT was transferred to BSWA by means of a loss portfolio transfer (LPT). This loss portfolio transfer was for all claims and incidents that had been reported to SIRT up to June 30, 2015. Assets have been transferred to BSWA in an amount equal to the actuarially determined expected value of the liabilities, and those assets have been separately invested, as described in the investment policy. The BHCS LPT is retrospectively rated, such that BHCS will be required to contribute additional funds should they be needed to cover claims under the BHCS LPT, and any surplus funds from the BHCS LPT will eventually be returned to BHCS.

Baylor Scott & White Medical Center - Marble Falls

In August 2015, the system opened Baylor Scott & white Medical Center – Marble Falls, a 46 bed full-service medical center dedicated to serving the residents of Marble Falls.

Tenet Transaction

The System and Tenet Healthcare Corporation (“Tenet”) announced on March 23, 2015 a definitive agreement to partner on providing care through five North Texas hospitals. The partnership will focus on delivering integrated, value-based care to communities in Rockwall,

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements – continued

Collin and Dallas counties. Through this new partnership, the two organizations will jointly own Centennial Medical Center, Doctors Hospital at White Rock Lake, Lake Pointe Medical Center, and Texas Regional Medical Center at Sunnyvale - currently owned and operated by subsidiaries of Tenet - and Baylor Medical Center at Garland. The System will hold a majority ownership interest in the five hospitals, and all five will operate under the Baylor Scott & White Health brand. The transaction is subject to regulatory review and customary closing conditions.

The System has performed an evaluation of subsequent events through November 11, 2015, which is the date the financial statements were issued.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Supplementary Unaudited Information

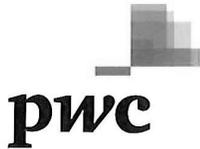
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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

OTHER COMMUNITY BENEFITS - UNAUDITED

Nonprofit hospitals are required to report community benefits under the requirements of Texas Health and Safety Code Chapter 311. For Texas state law purposes, unaudited community benefits include the unreimbursed cost of charity care; the unreimbursed cost of government-sponsored indigent health care (i.e., Medicaid); the unreimbursed cost of government-sponsored health care (i.e., Medicare), medical education, and other community benefits and services. The amount of community benefits reportable for Texas state law purposes by all Baylor and Scott & White nonprofit hospitals totaled approximately \$657,982,000 for the year ended June 30, 2015. The amount of community benefits reportable for Texas state law purposes for fiscal year 2014 totaled approximately \$701,800,000, which was comprised of the twelve months ended June 30, 2014 of Baylor hospitals and the ten months ended June 30, 2014 of Scott & White hospitals.



**Independent Auditor's Report
on Supplementary Combining Information**

To the Board of Trustees
Baylor Scott & White Holdings:

We have audited the combined financial statements of Baylor Scott & White Holdings and its controlled affiliates as of June 30, 2015 and for the year then ended and our report thereon appears on page one of this document. That audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining information is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole. The combining information is presented for purposes of additional analysis of the combined financial statements rather than to present the financial position, results of operations and changes in net assets and cash flows of the individual components and is not a required part of the combined financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and cash flows of the individual components.

PricewaterhouseCoopers LLP

November 11, 2015

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Combining Balance Sheets (Note A) June 30, 2015 (in thousands)

| | Obligated Affiliates | SWHP | Other System Entities | Reclassifications & Eliminations | Total Financials |
|---|-------------------------|-------------------|-----------------------------|-------------------------------------|---------------------|
| ASSETS | | | | | |
| CURRENT ASSETS: | | | | | |
| Cash and cash equivalents | \$ 767,172 | \$ 84,795 | \$ 333,318 | \$ - | \$ 1,185,285 |
| Short-term investments | 37,913 | 13,625 | 20,334 | - | 71,872 |
| THVG funds due from United Surgical Partners, Inc. | - | - | 58,876 | - | 58,876 |
| Accounts receivable: | | | | | |
| Patient, net | 386,145 | - | 305,501 | (54,009) | 637,637 |
| Premiums | - | 41,161 | - | - | 41,161 |
| Affiliates, net | - | - | 205,392 | (205,392) | - |
| Other | 154,547 | 13,009 | 74,471 | (1,269) | 240,758 |
| Other current assets | <u>113,913</u> | <u>6,767</u> | <u>80,517</u> | <u>18</u> | <u>201,215</u> |
| Total current assets | <u>1,459,690</u> | <u>159,357</u> | <u>1,078,409</u> | <u>(260,652)</u> | <u>2,436,804</u> |
| LONG-TERM INVESTMENTS: | | | | | |
| Unrestricted | 2,221,191 | 35,994 | 385,019 | - | 2,642,204 |
| Restricted | <u>-</u> | <u>-</u> | <u>451,244</u> | <u>-</u> | <u>451,244</u> |
| Total long-term investments | <u>2,221,191</u> | <u>35,994</u> | <u>836,263</u> | <u>-</u> | <u>3,093,448</u> |
| ASSETS WHOSE USE IS LIMITED: | | | | | |
| Other designated assets | 73,501 | 2,200 | 2,622 | - | 78,323 |
| Self insurance reserves | 47,554 | - | 34,714 | - | 82,268 |
| Funds held by bond trustee | <u>48,134</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>48,134</u> |
| Total assets whose use is limited | <u>169,189</u> | <u>2,200</u> | <u>37,336</u> | <u>-</u> | <u>208,725</u> |
| ASSETS HELD FOR SALE | - | - | 9,157 | - | 9,157 |
| PROPERTY AND EQUIPMENT, net | 2,130,318 | 16,870 | 1,245,754 | (21,132) | 3,371,810 |
| CONTRIBUTIONS RECEIVABLE, net | 3,085 | - | 67,345 | (65) | 70,365 |
| DUE FROM AFFILIATES | 407,528 | - | 3,190 | (410,718) | - |
| INTEREST IN NET ASSETS OF RELATED FOUNDATIONS | 454,817 | - | 103,167 | (553,949) | 4,035 |
| INVESTMENTS IN SUBSIDIARIES AND AFFILIATES | 899,203 | - | 4,574 | (903,777) | - |
| OTHER LONG-TERM ASSETS: | | | | | |
| Equity investment in unconsolidated entities | 71,063 | 181 | 32,279 | (33,049) | 70,474 |
| Goodwill and intangible assets, net | 20,164 | - | 396,175 | (25,596) | 390,743 |
| Other | <u>26,369</u> | <u>1,517</u> | <u>6,822</u> | <u>(2,852)</u> | <u>31,856</u> |
| Total other long-term assets | <u>117,596</u> | <u>1,698</u> | <u>435,276</u> | <u>(61,497)</u> | <u>493,073</u> |
| Total assets | <u>\$ 7,862,617</u> | <u>\$ 216,119</u> | <u>\$ 3,820,471</u> | <u>\$ (2,211,790)</u> | <u>\$ 9,687,417</u> |

Note (A): The supplemental combining financial information of the Obligated Affiliates and the BSWH System includes Obligated Affiliates, SWHP, Other System Entities, and Reclassifications and Eliminations. It has been prepared in a manner consistent with generally accepted accounting principles and is presented only for purposes of additional analysis and not as a presentation of financial position and results of operations of each component of the combined group. The supplemental combining financial information was derived from the accounting records used to prepare the combined financial statements. All material consolidating entries and intracompany/intercompany eliminations have been properly recorded.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Combining Balance Sheets - continued
(Note A)
June 30, 2015
(in thousands)

| | Obligated Affiliates | SWHP | Other System Entities | Reclassifications & Eliminations | Total Financials |
|--|-------------------------|-------------------|-----------------------------|-------------------------------------|---------------------|
| LIABILITIES | | | | | |
| CURRENT LIABILITIES: | | | | | |
| Current maturities of long-term debt and capital lease obligations | \$ 33,925 | \$ - | \$ 27,539 | \$ - | \$ 61,464 |
| Long-term debt subject to short-term remarketing arrangements | 95,000 | - | - | - | 95,000 |
| Accounts payable: | | | | | |
| Trade accounts payable | 149,026 | 5,933 | 129,154 | (5,460) | 278,653 |
| Affiliates, net | 210,384 | 814 | - | (211,198) | - |
| Accrued liabilities: | | | | | |
| Payroll related | 283,767 | 3,570 | 101,246 | - | 388,583 |
| Third party programs | 38,008 | - | 19,023 | - | 57,031 |
| Medical claims payable | - | 75,946 | - | (48,524) | 27,422 |
| Other | <u>153,240</u> | <u>37,548</u> | <u>85,805</u> | <u>(10,602)</u> | <u>265,991</u> |
| Total current liabilities | <u>963,350</u> | <u>123,811</u> | <u>362,767</u> | <u>(275,784)</u> | <u>1,174,144</u> |
| LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS: | | | | | |
| Less current maturities | <u>2,244,840</u> | - | <u>397,837</u> | - | <u>2,642,677</u> |
| OTHER LONG-TERM LIABILITIES: | | | | | |
| Self insurance and other insurance liabilities | 48,179 | - | 31,925 | - | 80,104 |
| Interest rate swap liabilities, net | 258,531 | - | - | - | 258,531 |
| Other | <u>116,236</u> | <u>8,762</u> | <u>100,140</u> | <u>(5,819)</u> | <u>219,319</u> |
| Total other long-term liabilities | <u>422,946</u> | <u>8,762</u> | <u>132,065</u> | <u>(5,819)</u> | <u>557,954</u> |
| DUE TO AFFILIATES | | | | | |
| Total liabilities | - | - | 410,751 | (410,751) | - |
| | <u>3,631,136</u> | <u>132,573</u> | <u>1,303,420</u> | <u>(692,354)</u> | <u>4,374,775</u> |
| COMMITMENTS AND CONTINGENCIES | | | | | |
| NONCONTROLLING INTERESTS - REEDEMABLE | | | | | |
| | - | - | 231,499 | 81,506 | 313,005 |
| NET ASSETS: | | | | | |
| Unrestricted - attributable to BSWH | 3,769,599 | 83,546 | 1,520,484 | (1,047,562) | 4,326,067 |
| Unrestricted - noncontrolling interests nonredeemable | <u>3,947</u> | - | <u>137,346</u> | <u>334</u> | <u>141,627</u> |
| Total unrestricted net assets | <u>3,773,546</u> | <u>83,546</u> | <u>1,657,830</u> | <u>(1,047,228)</u> | <u>4,467,694</u> |
| Temporarily restricted | 294,027 | - | 339,614 | (340,997) | 292,644 |
| Permanently restricted | <u>163,908</u> | - | <u>288,108</u> | <u>(212,717)</u> | <u>239,299</u> |
| Total net assets | <u>4,231,481</u> | <u>83,546</u> | <u>2,285,552</u> | <u>(1,600,942)</u> | <u>4,999,637</u> |
| Total liabilities and net assets | <u>\$ 7,862,617</u> | <u>\$ 216,119</u> | <u>\$3,820,471</u> | <u>\$ (2,211,790)</u> | <u>\$ 9,687,417</u> |

Note (A): The supplemental combining financial information of the Obligated Affiliates and the BSWH System includes Obligated Affiliates, SWHP, Other System Entities, and Reclassifications and Eliminations. It has been prepared in a manner consistent with generally accepted accounting principles and is presented only for purposes of additional analysis and not as a presentation of financial position and results of operations of each component of the combined group. The supplemental combining financial information was derived from the accounting records used to prepare the combined financial statements. All material consolidating entries and intracompany/intercompany eliminations have been properly recorded.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Combining Statements of Operations and Changes in Net Assets
(Note A)

For the Year Ended June 30, 2015

(in thousands)

| | Obligated Affiliates | SWHP | Other System Entities | Reclassifications & Eliminations | Total Financials |
|--|-------------------------|----------------|-----------------------------|-------------------------------------|---------------------|
| OPERATING REVENUE: | | | | | |
| Net patient care revenue | \$ 4,168,764 | \$ - | \$3,167,649 | \$ (361,027) | \$ 6,975,386 |
| Less patient related bad debt expense | <u>377,648</u> | <u>-</u> | <u>203,612</u> | <u>-</u> | <u>581,260</u> |
| Net patient care revenue, less patient related bad debt expense | 3,791,116 | - | 2,964,037 | (361,027) | 6,394,126 |
| Premium revenue | - | 695,853 | - | - | 695,853 |
| Other operating revenue | 219,019 | 32,304 | 1,002,734 | (877,321) | 376,736 |
| Net assets released from restrictions for operations | <u>8,723</u> | <u>-</u> | <u>70,497</u> | <u>(10,009)</u> | <u>69,211</u> |
| Total operating revenue | <u>4,018,858</u> | <u>728,157</u> | <u>4,037,268</u> | <u>(1,248,357)</u> | <u>7,535,926</u> |
| OPERATING EXPENSE: | | | | | |
| Salaries, wages and employee benefits | 1,684,768 | 35,355 | 1,849,463 | (38,667) | 3,530,919 |
| Supplies | 618,503 | 35,730 | 617,204 | - | 1,271,437 |
| Other operating expenses | 1,132,740 | 68,907 | 1,043,401 | (900,712) | 1,344,336 |
| Medical Claims | - | 593,555 | - | (322,682) | 270,873 |
| Losses on fixed asset disposals, net | (2,858) | - | 2,018 | - | (840) |
| Depreciation and amortization | 150,693 | 512 | 194,279 | (1,748) | 343,736 |
| Interest | <u>62,605</u> | <u>18</u> | <u>42,170</u> | <u>(11,230)</u> | <u>93,563</u> |
| Total operating expenses | <u>3,646,451</u> | <u>734,077</u> | <u>3,748,535</u> | <u>(1,275,039)</u> | <u>6,854,024</u> |
| INCOME (LOSS) FROM OPERATIONS BEFORE MERGER COSTS | <u>372,407</u> | <u>(5,920)</u> | <u>288,733</u> | <u>26,682</u> | <u>681,902</u> |
| MERGER COSTS | <u>9,571</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>9,571</u> |
| INCOME (LOSS) FROM OPERATIONS | <u>362,836</u> | <u>(5,920)</u> | <u>288,733</u> | <u>26,682</u> | <u>672,331</u> |
| NONOPERATING GAINS (LOSSES): | | | | | |
| Gain (losses) on investments, net | 52,083 | 1,395 | 14,524 | (11,230) | 56,772 |
| Interest rate swap activity | (69,244) | - | - | - | (69,244) |
| Contributions | 10,502 | - | 2,299 | (11,009) | 1,792 |
| Equity in earnings (losses) of unconsolidated entities | 2,049 | - | (6,023) | 16 | (3,958) |
| Loss from extinguishment of debt | (71,379) | - | - | - | (71,379) |
| Other | <u>122,433</u> | <u>(8)</u> | <u>11,014</u> | <u>(131,831)</u> | <u>1,608</u> |
| Total nonoperating gains (losses) | <u>46,444</u> | <u>1,387</u> | <u>21,814</u> | <u>(154,054)</u> | <u>(84,409)</u> |
| REVENUE AND GAINS IN EXCESS (DEFICIT) OF EXPENSES AND LOSSES BEFORE TAXES | 409,280 | (4,533) | 310,547 | (127,372) | 587,922 |
| INCOME TAX EXPENSE | <u>71</u> | <u>-</u> | <u>8,304</u> | <u>-</u> | <u>8,375</u> |
| REVENUE AND GAINS IN EXCESS (DEFICIT) OF EXPENSES AND LOSSES | 409,209 | (4,533) | 302,243 | (127,372) | 579,547 |

Note (A): The supplemental combining financial information of the Obligated Affiliates and the BSWH System includes Obligated Affiliates, SWHP, Other System Entities, and Reclassifications and Eliminations. It has been prepared in a manner consistent with generally accepted accounting principles and is presented only for purposes of additional analysis and not as a presentation of financial position and results of operations of each component of the combined group. The supplemental combining financial information was derived from the accounting records used to prepare the combined financial statements. All material consolidating entries and intracompany/intercompany eliminations have been properly recorded.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Combining Statements of Operations and Changes in Net Assets - continued

(Note A)

For the Year Ended June 30, 2015

(in thousands)

| | Obligated Affiliates | SWHP | Other System Entities | Reclassifications & Eliminations | Total Financials |
|--|-------------------------|------------------|-----------------------------|-------------------------------------|---------------------|
| OTHER CHANGES IN | | | | | |
| UNRESTRICTED NET ASSETS: | | | | | |
| Unrealized (losses) gains on investments, net | \$ - | \$ (5) | \$ 5,176 | \$ - | \$ 5,171 |
| Net assets released from restrictions for capital expenditures | 910 | - | 7,012 | (910) | 7,012 |
| Other changes in net assets attributable to noncontrolling interests-nonredeemable | (833) | - | (180,386) | 145,445 | (35,774) |
| Revenue and gains in excess of expenses and losses attributable to noncontrolling interests - redeemable | - | - | (150,830) | (46,134) | (196,964) |
| Transfers between entities under common control | (303,885) | 4,729 | 399,970 | (100,814) | - |
| Other | (11,236) | - | (3,917) | - | (15,153) |
| INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS | 94,165 | 191 | 379,268 | (129,785) | 343,839 |
| CHANGES IN TEMPORARILY RESTRICTED NET ASSETS: | | | | | |
| Contributions | 6,205 | - | 80,074 | (10,919) | 75,360 |
| Realized investment income | 36 | - | 29,898 | - | 29,934 |
| Unrealized losses on investments | - | - | (22,974) | - | (22,974) |
| Change in value of split-interest agreements | 9 | - | (12) | - | (3) |
| Net assets released from restrictions for operations | (8,723) | - | (70,497) | 10,009 | (69,211) |
| Net assets released from restrictions for capital expenditures | (910) | - | (7,012) | 910 | (7,012) |
| Transfer between entities under common control | (1,460) | - | 1,460 | - | - |
| Change in net assets of related foundation | 13,207 | - | (794) | (12,623) | (210) |
| Other | (2,607) | - | 588 | - | (2,019) |
| INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS | 5,757 | - | 10,731 | (12,623) | 3,865 |
| CHANGES IN PERMANENTLY RESTRICTED NET ASSETS: | | | | | |
| Contributions | - | - | 5,931 | - | 5,931 |
| Realized investment income | - | - | 662 | - | 662 |
| Unrealized losses on investments | - | - | (382) | - | (382) |
| Change in value of split-interest agreements | (549) | - | 900 | - | 351 |
| Change in net assets of related foundation | 11,320 | - | 513 | (11,805) | 28 |
| Other | 325 | - | 1,750 | - | 2,075 |
| INCREASE (DECREASE) IN PERMANENTLY RESTRICTED NET ASSETS | 11,096 | - | 9,374 | (11,805) | 8,665 |
| INCREASE (DECREASE) IN NET ASSETS | 111,018 | 191 | 399,373 | (154,213) | 356,369 |
| NET ASSETS, beginning of period | <u>4,120,463</u> | <u>83,355</u> | <u>1,886,179</u> | <u>(1,446,729)</u> | <u>4,643,268</u> |
| NET ASSETS, end of period | <u>\$ 4,231,481</u> | <u>\$ 83,546</u> | <u>\$ 2,285,552</u> | <u>\$ (1,600,942)</u> | <u>\$ 4,999,637</u> |

Note (A): The supplemental combining financial information of the Obligated Affiliates and the BSWH System includes Obligated Affiliates, SWHP, Other System Entities, and Reclassifications and Eliminations. It has been prepared in a manner consistent with generally accepted accounting principles and is presented only for purposes of additional analysis and not as a presentation of financial position and results of operations of each component of the combined group. The supplemental combining financial information was derived from the accounting records used to prepare the combined financial statements. All material consolidating entries and intracompany/intercompany eliminations have been properly recorded.

APPENDIX B-2

**UNAUDITED INTERIM COMBINED FINANCIAL STATEMENTS
OF BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES
FOR THE SIX MONTHS ENDED
DECEMBER 31, 2015 AND 2014**

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BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

COMBINED BALANCE SHEETS – DECEMBER 31, 2015 (UNAUDITED) AND JUNE 30, 2015
(In thousands)

| ASSETS | December 31, 2015 | June 30, 2015 | LIABILITIES AND NET ASSETS | December 31, 2015 | June 30, 2015 |
|---|----------------------|---------------------|---|----------------------|---------------------|
| CURRENT ASSETS: | | | CURRENT LIABILITIES: | | |
| Cash and cash equivalents | \$ 949,523 | \$ 1,185,285 | Current maturities of long-term debt and capital lease obligations | \$ 88,946 | \$ 61,464 |
| Short-term investments | 83,614 | 71,872 | Long-term debt subject to short-term remarketing arrangements | 95,000 | 95,000 |
| THVG funds due from United Surgical Partners, Inc. | 79,566 | 58,876 | Trade accounts payable | 212,839 | 278,653 |
| Accounts receivable: | | | Accrued liabilities: | | |
| Patient, net of allowance for uncollectibles of \$332,991 and \$346,047 in December and June 2015 | 693,642 | 637,637 | Payroll related | 268,217 | 388,583 |
| Premiums | 62,764 | 41,161 | Third-party programs | 74,707 | 57,031 |
| Other | 316,028 | 240,758 | Medical claims payable | 21,647 | 27,422 |
| Other current assets | <u>517,905</u> | <u>201,215</u> | Other | <u>328,865</u> | <u>265,991</u> |
| Total current assets | <u>2,703,042</u> | <u>2,436,804</u> | Total current liabilities | <u>1,090,221</u> | <u>1,174,144</u> |
| LONG-TERM INVESTMENTS: | | | LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current maturities | 2,781,806 | 2,642,677 |
| Unrestricted | 2,639,295 | 2,642,204 | OTHER LONG-TERM LIABILITIES: | | |
| Restricted | <u>419,577</u> | <u>451,244</u> | Self insurance and other insurance liabilities | 97,495 | 80,104 |
| Total long-term investments | <u>3,058,872</u> | <u>3,093,448</u> | Interest rate swap liability, net | 296,486 | 258,531 |
| ASSETS WHOSE USE IS LIMITED: | | | Other | <u>236,536</u> | <u>219,319</u> |
| Other designated assets | 77,599 | 78,323 | Total other long-term liabilities | <u>630,517</u> | <u>557,954</u> |
| Self insurance investments | 99,111 | 82,268 | Total liabilities | <u>4,502,544</u> | <u>4,374,775</u> |
| Funds held by bond trustee | <u>46,486</u> | <u>48,134</u> | COMMITMENTS AND CONTINGENCIES | | |
| Total assets whose use is limited | <u>223,196</u> | <u>208,725</u> | NONCONTROLLING INTERESTS – REDEEMABLE | 333,239 | 313,005 |
| ASSETS HELD FOR SALE | 9,157 | 9,157 | NET ASSETS: | | |
| PROPERTY AND EQUIPMENT, net | 3,348,622 | 3,371,810 | Unrestricted - attributable to BSWH | 4,400,876 | 4,326,067 |
| CONTRIBUTIONS RECEIVABLE, net | 68,990 | 70,365 | Unrestricted - noncontrolling interests nonredeemable | <u>164,920</u> | <u>141,627</u> |
| INTEREST IN NET ASSETS OF RELATED FOUNDATIONS | 4,035 | 4,035 | Total unrestricted net assets | 4,565,796 | 4,467,694 |
| OTHER LONG-TERM ASSETS: | | | Temporarily restricted | 273,074 | 292,644 |
| Equity investments in unconsolidated entities | 68,443 | 70,474 | Permanently restricted | <u>243,874</u> | <u>239,299</u> |
| Goodwill and intangible assets, net | 405,333 | 390,743 | Total net assets | <u>5,082,744</u> | <u>4,999,637</u> |
| Other | <u>28,837</u> | <u>31,856</u> | Total liabilities and net assets | <u>\$ 9,918,527</u> | <u>\$ 9,687,417</u> |
| Total other long-term assets | <u>502,613</u> | <u>493,073</u> | | | |
| Total assets | <u>\$ 9,918,527</u> | <u>\$ 9,687,417</u> | | | |

See accompanying notes.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2015 and 2014 (UNAUDITED)
(In thousands)

| | <u>2015</u> | <u>2014</u> |
|---|------------------|------------------|
| OPERATING REVENUE: | | |
| Net patient care revenue | \$ 3,814,900 | \$ 3,420,566 |
| Less patient related bad debt expense | <u>334,166</u> | <u>287,399</u> |
| Net patient care revenue, net of patient related bad debt expense | 3,480,734 | 3,133,167 |
| Premium revenue | 387,422 | 339,065 |
| Other operating revenue | 144,505 | 151,297 |
| Net assets released from restrictions for operations | <u>27,992</u> | <u>31,593</u> |
| Total operating revenue | <u>4,040,653</u> | <u>3,655,122</u> |
| OPERATING EXPENSES: | | |
| Salaries, wages, and employee benefits | 1,890,281 | 1,721,828 |
| Supplies | 703,386 | 616,127 |
| Other operating expenses | 719,467 | 658,742 |
| Medical claims | 115,037 | 119,885 |
| Gains on fixed asset sales and disposals, net | (4,149) | (503) |
| Depreciation and amortization | 177,881 | 168,785 |
| Interest | <u>48,761</u> | <u>45,555</u> |
| Total operating expenses | <u>3,650,664</u> | <u>3,330,419</u> |
| INCOME FROM OPERATIONS | <u>389,989</u> | <u>324,703</u> |
| NONOPERATING GAINS (LOSSES): | | |
| Losses on investments, net | (104,206) | (17,750) |
| Interest rate swap activity | (49,231) | (78,962) |
| Contributions | 380 | 980 |
| Equity in losses in unconsolidated entities | (875) | (3,780) |
| Loss from extinguishment of debt | (1,748) | (1,247) |
| Other | <u>(445)</u> | <u>(551)</u> |
| Total nonoperating losses | <u>(156,125)</u> | <u>(101,310)</u> |
| REVENUE AND GAINS IN EXCESS OF EXPENSES AND LOSSES BEFORE INCOME TAXES | 233,864 | 223,393 |
| LESS INCOME TAX EXPENSE | <u>6,955</u> | <u>5,312</u> |
| REVENUE AND GAINS IN EXCESS OF EXPENSES AND LOSSES | 226,909 | 218,081 |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS -
continued

FOR THE SIX MONTHS ENDED DECEMBER 31, 2015 and 2014 (UNAUDITED)
(In thousands)

| | <u>2015</u> | <u>2014</u> |
|--|---------------------|---------------------|
| OTHER CHANGES IN UNRESTRICTED NET ASSETS: | | |
| Unrealized (losses) gains on investments, net | \$ (1,611) | \$ 5,092 |
| Net assets released from restrictions for capital expenditures | 16,394 | 3,133 |
| Other changes in net assets attributable to non-controlling interests - nonredeemable | (15,458) | (24,027) |
| Revenue and gains in excess of expenses and losses attributable to noncontrolling interests - redeemable | (128,278) | (111,570) |
| Other | <u>146</u> | <u>(1,138)</u> |
| INCREASE IN UNRESTRICTED NET ASSETS | <u>98,102</u> | <u>89,571</u> |
| CHANGES IN TEMPORARILY RESTRICTED NET ASSETS: | | |
| Contributions | 36,076 | 33,346 |
| Realized gains and investment income, net | 5,048 | 10,856 |
| Unrealized losses on investments, net | (15,479) | (15,563) |
| Change in value of split-interest agreements | (548) | 129 |
| Net assets released from restrictions for operations | (27,992) | (31,593) |
| Net assets released from restrictions for capital expenditures | (16,394) | (3,133) |
| Other | <u>(281)</u> | <u>(145)</u> |
| DECREASE IN TEMPORARILY RESTRICTED NET ASSETS | <u>(19,570)</u> | <u>(6,103)</u> |
| CHANGES IN PERMANENTLY RESTRICTED NET ASSETS: | | |
| Contributions | 5,238 | 1,042 |
| Realized gains and investment income, net | 434 | 540 |
| Unrealized losses on investments, net | (330) | (360) |
| Change in value of split-interest agreements | (724) | 127 |
| Other | <u>(43)</u> | <u>427</u> |
| INCREASE IN PERMANENTLY RESTRICTED NET ASSETS | <u>4,575</u> | <u>1,776</u> |
| INCREASE IN NET ASSETS | <u>83,107</u> | <u>85,244</u> |
| NET ASSETS, beginning of period | <u>4,999,637</u> | <u>4,643,268</u> |
| NET ASSETS, end of period | <u>\$ 5,082,744</u> | <u>\$ 4,728,512</u> |

See accompanying notes.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2015 and 2014 (UNAUDITED)
(In thousands)

| | 2015 | 2014 |
|---|------------------|------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Increase in net assets | \$ 83,107 | \$ 85,244 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Loss from extinguishment of debt | 1,748 | 1,247 |
| Unrealized losses on investments, net | 155,864 | 90,139 |
| Realized gains on investments, net | (17,948) | (48,777) |
| Unrealized losses on interest rate swap, net | 42,545 | 72,226 |
| Contributions restricted for long-term purposes | (5,238) | (1,042) |
| Patient related bad debt expense | 334,166 | 287,399 |
| Depreciation and amortization | 177,881 | 168,785 |
| Gains on fixed asset sales or disposals, net | (4,149) | (3,932) |
| Change in value of split-interest agreements | 1,272 | (256) |
| Deferred rent | (1,948) | 2,165 |
| Other changes attributable to noncontrolling interests | 143,736 | 135,597 |
| Changes in operating assets and liabilities (net of acquisitions): | | |
| Increase in net patient accounts receivable | (389,579) | (327,371) |
| (Increase) decrease in other accounts receivable | (96,904) | 32,289 |
| (Increase) decrease in other assets | (21,893) | 9,853 |
| Decrease in trade accounts payable and accrued liabilities | (102,560) | (55,192) |
| Increase in other liabilities | <u>38,366</u> | <u>24,631</u> |
| Net cash provided by operating activities | <u>338,466</u> | <u>473,005</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (163,939) | (232,201) |
| Cash proceeds from sales of assets | 8,786 | 14,040 |
| Cash paid for acquisitions, net of cash received | (14,055) | - |
| Advance payments for acquisitions | (288,810) | - |
| Increase in THVG funds due from United Surgical Partners, Inc. | (20,690) | (950) |
| (Increase) decrease in trading investments | (117,517) | 10,511 |
| Payments on interest rate swap | (6,686) | (6,736) |
| Decrease in other than trading investments | 2,069 | 1,560 |
| Decrease in investments of insurance subsidiaries | - | 2,141 |
| Increase in invested collateral-securities lending program | - | (40,806) |
| (Increase) decrease in assets whose use is limited | <u>(14,471)</u> | <u>50,435</u> |
| Net cash used in investing activities | <u>(615,313)</u> | <u>(202,006)</u> |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

COMBINED STATEMENTS OF CASH FLOWS - continued

FOR THE SIX MONTHS ENDED DECEMBER 31, 2015 and 2014 (UNAUDITED)
(In thousands)

| | 2015 | 2014 |
|--|--------------|-------------|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Principal payments on long-term debt | \$ (218,464) | \$ (69,759) |
| Proceeds from issuance of long-term debt | 384,888 | 28,620 |
| Increase in payable under securities lending program | - | 40,806 |
| Distributions to noncontrolling interests owners | (153,095) | (125,458) |
| Purchases of noncontrolling interests | (9,920) | (7,651) |
| Sales of noncontrolling interests | 35,651 | 12,469 |
| Cash receipts restricted for long-term purposes | 2,514 | 1,871 |
| Annuity payments to beneficiaries | (489) | (565) |
| Net cash provided by (used in) financing activities | 41,085 | (119,667) |
| | | |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (235,762) | 151,332 |
| | | |
| CASH AND CASH EQUIVALENTS, beginning of period | 1,185,285 | 743,908 |
| | | |
| CASH AND CASH EQUIVALENTS, end of period | \$ 949,523 | \$ 895,240 |
| | | |
| SUPPLEMENTAL CASH FLOW DATA: | | |
| Cash paid for interest | \$ 47,458 | \$ 44,179 |
| Cash paid for income tax | \$ 967 | \$ 70 |
| Property and equipment acquired under capital leases | \$ 161 | \$ 45 |
| Decrease in accounts payable due to property and equipment received but not paid | \$ (8,269) | \$ (11,947) |

See accompanying notes.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited)

For the Six Months ended December 31, 2015 and 2014

1. ORGANIZATION

Baylor Scott & White Holdings, a Texas nonprofit organization (BSW Holdings), and its controlled affiliates (collectively, the “System”) was created from the combination of two Texas healthcare systems, Baylor Health Care System (BHCS) and its affiliates and Scott & White Healthcare (SWH) and its affiliates. BSW Holdings and Baylor Scott & White Health, a Texas nonprofit corporation (BSW Health), were created by BHCS and S&W in connection with their combination. BSW Holdings is the sole member of BHCS, S&W, and BSW Health and has control and substantial reserved powers over all BHCS and S&W material affiliates. BHCS and its material affiliates are collectively referred to as “Baylor”. SWH and its material affiliates are collectively referred to as “Scott & White”. BSW Holdings and its affiliates are collectively referred to as the “System” or “BSWH”.

The combined financial statements include the accounts of BSW Holdings, BSW Health, BHCS, SWH, Baylor University Medical Center (BUMC), Scott & White Memorial Hospital (SWMH), Scott & White Health Plan (the “Health Plan” or “SWHP”), five foundations, nineteen community and specialty medical centers located throughout the Dallas and Fort Worth metroplex and the central Texas area, two wholly owned insurance subsidiaries, Baylor Quality Health Alliance, LLC, an accountable care organization, four physician practice organizations, HealthTexas Provider Network and Scott & White Clinic, Hillcrest Family Health Center and Hillcrest Physician Services, and other related entities. Investments in certain related entities with 50.0% or less ownership are accounted for using the equity method. The transactions and balances for investments in certain related entities with greater than 50.0% ownership or where the System exercises board control are included in the accompanying combined financial statements with related noncontrolling interests reported in the combined financial statements. These entities include partnerships in Texas Health Ventures Group, LLC (THVG), providing short stay hospital and outpatient surgery services, BIR JV, LLP, providing rehabilitation services, BTDI JV, LLP, providing imaging services, EBD JV, LLP and ESWCT, LLC, providing emergency medical services and THVG Bariatric, LLC, providing bariatric services. All significant intercompany accounts and transactions among entities included in the combined financial statements have been eliminated.

Baylor Scott & White Assurance SPC - Loss Portfolio Transfer

Effective July 1, 2015, the primary healthcare professional and general liability, physician professional liability, workers compensation and directors’ and officers’ coverage provided by the Self-Insurance Retention Trust (SIRT) was transferred to Baylor Scott & White Assurance

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

SPC (BSWA) by means of a loss portfolio transfer (LPT). This loss portfolio transfer was for all claims and incidents that had been reported to SIRT up to June 30, 2015. Assets have been transferred to BSWA in an amount equal to the actuarially determined expected value of the liabilities, and those assets have been separately invested, as described in the investment policy. The BHCS LPT is retrospectively rated, such that BHCS will be required to contribute additional funds should they be needed to cover claims under the BHCS LPT, and any surplus funds from the BHCS LPT will eventually be returned to BHCS.

Baylor Scott & White Medical Center - Marble Falls

In August 2015, the System opened Baylor Scott & White Medical Center – Marble Falls, a 46 bed full-service medical center dedicated to serving the residents of Marble Falls and the surrounding Hill Country area.

THVG

THVG completed the acquisition of one outpatient center in the six months ended December 31, 2015. THVG recorded goodwill and intangible net assets, net of approximately \$11,847,000, fixed assets of approximately \$128,000, and other net liabilities of approximately \$11,975,000.

Series 2015B, C & D Revenue Bonds

On December 23, 2015, BSW Holdings placed its Series 2015B, 2015C and 2015D revenue bonds (the “BSW Holdings Series 2015B, C and D”) with various banks. Proceeds of the BSW Holdings Series 2015B, C and D were used to refinance the following variable rate demand bonds issued via the Tarrant County Cultural Education Facilities Corporation conduit issuer: Hospital Revenue Bonds (Scott and White Memorial Hospital and Scott, Sherwood and Brindley Foundation Project) Series 2008-1, Hospital Revenue Bonds (Baylor Health Care System Project) Series 2011D, and Hospital Revenue Bonds (Baylor Health Care System Project) Series 2011E (collectively, the “Refinanced VRDBs”) with an aggregate outstanding balance of \$174,835,000. In conjunction with the Refinanced VRDBs, three direct-pay letters of credit were terminated; two with Wells Fargo Bank, N.A. and one with J.P. Morgan Bank, N.A. A loss on extinguishment of debt of approximately \$1,748,000 was recorded related to this transaction.

2. SIGNIFICANT ACCOUNTING POLICIES

The accompanying interim unaudited combined financial statements are prepared on the accrual basis of accounting in accordance with the United States generally accepted accounting principles. They do not include all of the information and notes required by United States generally accepted accounting principles for complete financial statements of

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

the System. Eliminations and reporting adjustments have been made to present the information in accordance with United States generally accepted accounting principles. The data should be read in conjunction with the audited combined financial statements unless noted accordingly, for the fiscal years ended June 30, 2015 and 2014 and related notes included in Appendix B-1. Information for the six months ended December 31, 2015 and 2014 is not based upon audited information but, in the opinion of management, is presented on a basis consistent with the audited combined financial statements in Appendix B-1 unless noted accordingly, and includes adjustments consisting of normal recurring adjustments necessary for a fair statement therein. The results of operations for the six months ended December 31, 2015 are not necessarily indicative of the operating results to be expected for the fiscal year ending June 30, 2016.

The combined balance sheet at June 30, 2015 has been derived from the audited combined financial statements at that date, but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

Cash and Cash Equivalents

Cash equivalents are defined as investments which have original maturities of three months or less. Cash equivalents consist primarily of securities issued by the United States government or its agencies, certificates of deposit, commercial paper and dollar denominated foreign issuer investments.

THVG Funds Due From United Surgical Partners, Inc.

THVG participates in a shared services accounts payable program with USPI, wherein USPI has custody of substantially all of THVG's cash, paying THVG and its facilities interest income on the net balance at prevailing market rates. Amounts held by USPI on behalf of THVG totaled approximately \$79,566,000 and \$58,876,000 at December 31, 2015 and June 30, 2015, respectively. The funds due from USPI are available on demand.

Investments

The System has designated all of its investments as trading except for those investments held at the Baptist Foundation of Texas (BFT) for the benefit of the BHCS Foundation and the investments of the Health Plan. For all trading investments, the interest and dividends, realized gains and unrealized gains (losses) are included in gains on investments, net, in the accompanying combined statements of operations and changes in net assets. For other than trading investments, interest and dividends and realized gains (losses) are included in gains on investments, net, unless restricted by donor. Unrealized gains (losses) on other than trading investments are included in other changes in unrestricted net assets, unless restricted by donor.

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements (Unaudited) - continued

Interest and dividends, realized gains and unrealized gains (losses) for the six months ended December 31, 2015 and 2014 consisted of the following (in thousands):

| | December 31, 2015 | | | Total |
|---|---------------------------|-------------------|----------------------|--------------------|
| | Interest and dividends | Realized gains | Unrealized losses | |
| Nonoperating gains (losses) | \$ 18,590 | \$ 15,648 | \$(138,444) | \$(104,206) |
| Other changes in unrestricted net assets | - | - | (1,611) | (1,611) |
| Changes in temporarily restricted net assets | 3,182 | 1,866 | (15,479) | (10,431) |
| Changes in permanently restricted net assets | - | 434 | (330) | 104 |
| | <u>\$ 21,772</u> | <u>\$ 17,948</u> | <u>\$(155,864)</u> | <u>\$(116,144)</u> |

| | December 31, 2014 | | | Total |
|---|---------------------------|-------------------|------------------------------|-------------------|
| | Interest and dividends | Realized gains | Unrealized gains (losses) | |
| Nonoperating gains (losses) | \$ 20,136 | \$ 41,422 | \$ (79,308) | \$ (17,750) |
| Other changes in unrestricted net assets | - | - | 5,092 | 5,092 |
| Changes in temporarily restricted net assets | 4,041 | 6,815 | (15,563) | (4,707) |
| Changes in permanently restricted net assets | - | 540 | (360) | 180 |
| | <u>\$ 24,177</u> | <u>\$ 48,777</u> | <u>\$(90,139)</u> | <u>\$(17,185)</u> |

Securities Lending Program

The System participates in securities lending transactions with The Northern Trust Company, investment custodian, whereby a portion of its investments is loaned to selected established brokerage firms in return for cash and securities from the brokers as collateral for the investments loaned, usually on a short-term basis of 30 to 60 days. Collateral provided by brokers is maintained at levels approximating 102.0% of the fair value of the securities on loan and is adjusted for daily market fluctuations. Cash collateral received in connection with these loans is invested in a short-term pooled fund maintained by the lending agent. As the System completed its post-merger assimilation activities related to the investment portfolio, this program was suspended in fiscal year 2015. There are no securities on loan at December 31, 2015 and June 30, 2015.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

Goodwill and Intangible Assets

Goodwill and intangible assets recorded in connection with acquisitions completed by the System are accounted for under Accounting Standards Codification (ASC) 350, "*Intangibles – Goodwill and Other*." Goodwill consists of costs in excess of tangible and intangible net assets acquired. Intangible assets consist of management service contract rights and other intangibles. Most of these intangible assets have indefinite lives.

Goodwill and indefinite-lived intangible assets are tested for impairment annually or more frequently if changing circumstances warrant. No impairments were identified in the six months ended December 31, 2015 and 2014.

The System amortizes finite-lived intangible assets over their respective lives to the estimated residual values and reviews for impairment in the same manner as long-lived assets discussed below. No impairments were identified for the six months ended December 31, 2015 and 2014.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset, or related groups of assets, may not be recoverable from estimated future cash flows. In the event of impairment, measurement of the amount of impairment may be based on appraisal, fair values of similar assets or estimates of future discounted cash flows resulting from the use and ultimate disposition of the asset. No impairments were identified in 2015 and 2014.

Medical Claims Payable

Medical claims payable represents management's best estimate of the ultimate net cost of all reported and unreported claims and claim adjustment expenses incurred through December 31, 2015 and June 30, 2015. Reserves for unpaid claims are actuarially estimated using individual case-basis valuations and statistical analysis. These estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that reserves for unpaid claims are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in operations when determined. There were no material adjustments to these estimates recorded during the six months ended December 31, 2015 and 2014.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

Income Taxes

Due to the organizational structure, certain of the System's entities are taxable under the Internal Revenue Code and some entities are tax exempt but are required to pay income taxes for unrelated business activities. The overall impact of federal income taxes to the System's combined financial statements is not significant. In addition, certain of the System's entities file partnership income tax returns in the U.S. federal jurisdiction and franchise tax returns in the State of Texas. These entities are no longer subject to U.S. federal, state and local income tax examinations by authorities for years prior to 2011.

The Texas franchise tax applies to certain of the System's entities. The tax is calculated on a margin basis and is therefore reflected in the System's combined statements of operations and changes in net assets as income tax expense.

The System follows the provisions of ASC 740, "*Income Taxes*." As of December 31, 2015 and June 30, 2015, the System had no material gross unrecognized tax benefits.

Contributions and Gifts

When received or pledged, unrestricted gifts are reported as contributions to unrestricted net assets, and donor-restricted items are reported as contributions to temporarily or permanently restricted net assets. These donor-restricted contributions are restricted as to use and are transferred from temporarily restricted net assets to unrestricted net assets when the restrictions are satisfied or in the case of endowment funds, when related earnings are appropriated for expenditure.

Revenue and Gains in Excess of Expenses and Losses

The combined statements of operations and changes in net assets include revenues and gains in excess of expenses and losses. Other changes in unrestricted net assets which are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include unrealized gains on investments other than trading securities, transactions related to noncontrolling interests, and net assets released from restrictions for capital expenditures.

Derivative Financial Instruments

ASC 815, "*Derivatives and Hedging*," requires that all derivative financial instruments be recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. Changes in the fair value of derivative financial instruments are recognized periodically in nonoperating gains (losses). The System's policy is to not hold or issue derivatives for trading purposes and to avoid derivatives with leverage features.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

Use of Estimates

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

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value Measurements

As defined in ASC 820, "*Fair Value Measurement*," fair value is based on the prices 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. In order to increase consistency and comparability in fair value measurements, ASC 820 establishes a three-tier fair value hierarchy for disclosure of fair value measurements.

The valuation hierarchy is 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 by market participants for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - Inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability are unobservable and developed based on the best information available in the circumstances.

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.

The carrying values of cash and cash equivalents, THVG funds due from USPI, patient accounts receivable, other receivables, accounts payable, payable under securities lending program, accrued liabilities, and estimated third-party payor settlements payable are reasonable estimates of their fair value due to the short-term nature of these financial instruments.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

Fair values of short-term investments and long-term investments are generally 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 are obtained from various sources including market participants, dealers, and brokers. This applies to investments such as domestic equities, U.S. treasuries, exchange-traded mutual funds, and agency securities.

Alternative Investments

Investments held consist of marketable securities as well as securities that do not have readily determinable fair values. Private equity investments, real estate investments and hedge funds are collectively referred to as “alternative investments”. These are included in unrestricted long-term investments in the accompanying combined balance sheets, other than those held at BFT. The investments in alternative investments are valued by management at fair value utilizing the net asset value (NAV) provided by the underlying investment companies unless management determines some other valuation is more appropriate. Such fair value estimates do not reflect early redemption penalties as the System does not intend to sell such investments before the expiration of the early redemption periods. The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner and are based on historical cost, appraisals, or other estimates that require varying degrees of judgment. If no public market exists for the investment securities, the fair value is determined by the general partner taking into consideration, among other things, the cost of securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate. As this valuation methodology is based primarily on unobservable inputs, these investments represent Level 3 assets. Any hedge funds valued at NAV which are redeemable by the System at NAV per share (or its equivalent) at the measurement date are transferred from Level 3 assets to Level 2 assets. Any hedge funds valued at NAV that were classified in prior year as Level 2 assets that are not redeemable by the System at NAV per share (or its equivalent) at the measurement date are transferred from Level 2 assets to Level 3 assets.

Included in collective investment funds held at BFT for the BHCS Foundation are alternative investment interests in private equity funds and oil and gas interests. These interests are included in restricted long-term investments in the accompanying combined balance sheets. These alternative investments are in limited partnership interests and are carried at the NAV provided by the underlying investment companies unless management determines some other

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

valuation is more appropriate. As this valuation methodology is based primarily on unobservable inputs, these investments represent Level 3 assets. Also included in Level 3 assets for the BHCS Foundation are other real estate and oil and gas interests which are carried at lower of cost or market.

Beneficial Interest

The System records charitable remainder trusts, where they are not the trustee, at the discounted present value of the estimated future cash flows. These trusts are reported in contributions receivable, net, in the accompanying combined balance sheets. When a third-party serves as trustee, the beneficial interest is required to be measured at fair value on a recurring basis. As beneficial interests utilize multiple unobservable inputs, including no active markets, and are measured using management's assumption about risk inherent in the valuation technique, beneficial interests in split-interest agreements represent Level 3 assets.

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.

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements (Unaudited) - continued

The following table sets forth below, by level, the financial assets and liabilities measured at fair value on a recurring basis at December 31, 2015 (in thousands):

| | December 31, 2015 | | | |
|---------------------------------|-------------------|----------------|---------------|---------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash and cash equivalents | | | | |
| Cash | \$ 909,814 | \$ 909,814 | \$ - | \$ - |
| Money market funds | <u>39,709</u> | <u>39,709</u> | - | - |
| Total cash and cash equivalents | <u>949,523</u> | <u>949,523</u> | - | - |
| Short-term investments | | | | |
| Mutual funds | 40,586 | 40,586 | - | - |
| Certificates of deposit | 9,671 | 9,671 | - | - |
| Fixed income securities | 25,621 | - | 25,621 | - |
| U.S. government securities | 6,642 | 1,403 | 5,239 | - |
| Other | <u>1,094</u> | <u>1,094</u> | - | - |
| Total short-term investments | <u>83,614</u> | <u>52,754</u> | <u>30,860</u> | - |

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements (Unaudited) - continued

| | December 31, 2015 | | | |
|---|-------------------|----------|-----------|---------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets (continued): | | | | |
| Unrestricted long-term investments | | | | |
| Cash | \$ 7,091 | \$ 7,091 | \$ - | \$ - |
| Mutual funds | 4,577 | 4,577 | - | - |
| Equity securities | 980,995 | 408,141 | 572,854 | - |
| Fixed income securities | 424,237 | 24 | 424,213 | - |
| U.S. government securities | 272,716 | 4,203 | 268,513 | - |
| Mortgage-backed securities | 135,915 | 35,743 | 100,172 | - |
| Hedge fund/diversifiers alternative investments | 482,630 | - | 350,623 | 132,007 |
| Private equity alternative investments | 154,292 | - | - | 154,292 |
| Real estate alternative investments | 100,040 | - | - | 100,040 |
| Common funds, held at Baptist Foundation of Texas (BFT) | | | | |
| Group investment fund | 272 | - | 272 | - |
| Group bond fund | 17 | - | 17 | - |
| Group equity fund | 37 | - | 37 | - |
| Other funds | 14 | 9 | - | 5 |
| Other | 270 | - | - | 270 |
| Total unrestricted long-term investments | 2,563,103 | 459,788 | 1,716,701 | 386,614 |

In the accompanying combined balance sheets, unrestricted long term investments, at December 31, 2015, includes an investment of approximately \$76,192,000 accounted for under the cost method.

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**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements (Unaudited) - continued

| | December 31, 2015 | | | |
|---|-------------------|----------------|----------------|---------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets (continued): | | | | |
| Restricted long-term investments | | | | |
| Cash | \$ 38,058 | \$ 38,058 | \$ - | \$ - |
| Mutual funds | 20,805 | 20,805 | - | - |
| Equity securities | 140,549 | 57,309 | 83,240 | - |
| Fixed income securities | 33,773 | 47 | 33,726 | - |
| U.S. government securities | 23,129 | 2,470 | 20,659 | - |
| Mortgage-backed securities | 10,528 | 2,789 | 7,739 | - |
| Hedge fund/diversifiers alternative investments | 55,303 | - | 38,199 | 17,104 |
| Private equity alternative investments | 29,997 | - | - | 29,997 |
| Real estate alternative investments | 9,812 | - | - | 9,812 |
| Municipal bonds | 4,517 | - | 4,517 | - |
| Real estate | 852 | - | - | 852 |
| Cash surrender value of life insurance | 1,258 | - | - | 1,258 |
| Common funds, held at Baptist Foundation of Texas (BFT) | | | | |
| Group investment fund | 40,892 | - | 40,892 | - |
| Group bond fund | 2,604 | - | 2,604 | - |
| Group equity fund | 5,624 | - | 5,624 | - |
| Other funds | 1,876 | 1,169 | - | 707 |
| Total restricted long-term investments | <u>419,577</u> | <u>122,647</u> | <u>237,200</u> | <u>59,730</u> |
| Assets whose use is limited | | | | |
| Cash | 22,036 | 22,036 | - | - |
| Mutual funds | 107,776 | 107,776 | - | - |
| Equity securities | 17,756 | 17,756 | - | - |
| Fixed income securities | 35,457 | - | 35,457 | - |
| U.S. governments securities | 30,116 | - | 30,116 | - |
| Mortgage-backed securities | 9,888 | - | 9,888 | - |
| Other | 167 | 167 | - | - |
| Total assets whose use is limited | <u>223,196</u> | <u>147,735</u> | <u>75,461</u> | <u>-</u> |

**BAYLOR SCOTT & WHITE HOLDINGS
AND ITS CONTROLLED AFFILIATES**

Notes to Combined Financial Statements (Unaudited) - continued

| | December 31, 2015 | | | |
|--|-------------------|-------------|-------------|------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets (continued): | | | | |
| Contributions receivable, net | | | | |
| Beneficial interest in split-interest agreements | \$ 21,573 | \$ - | \$ - | \$ 21,573 |
| Total contributions receivable, net | 21,573 | - | - | 21,573 |
| Total assets at fair value | \$4,260,586 | \$1,732,447 | \$2,060,222 | \$ 467,917 |
| Liabilities: | | | | |
| Interest rate swap agreements, net of collateral | \$ 296,486 | \$ - | \$ 296,486 | \$ - |
| Total liabilities at fair value | \$ 296,486 | \$ - | \$ 296,486 | \$ - |

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BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

The following table is a roll forward of the combined balance sheet amounts for financial instruments classified by the System within Level 3 of the valuation hierarchy defined above for the six months ended December 31, 2015 (in thousands):

| | December 31, 2015 | | | | | | |
|--------------------------------|-------------------|-------------------|-------------------|-----------------|------------------------------|---------------------|-------------------|
| | Private Equity | Real Estate | Hedge Funds | Other Funds | Split-Interest Agreements | Investment Funds | Total |
| Balance, beginning of period | \$ 182,479 | \$ 94,031 | \$ 144,055 | \$ 2,376 | \$ 22,645 | \$ 803 | \$ 446,389 |
| Realized gains (losses), net | 4,897 | 1,244 | (2,726) | - | (301) | - | 3,114 |
| Unrealized gains (losses), net | 6,758 | (1,507) | (24,306) | - | (1,059) | (91) | (20,205) |
| Purchases | 55,524 | 113,656 | 16,955 | 11 | 288 | - | 186,434 |
| Settlements | (65,369) | (97,572) | (13,316) | (7) | - | - | (176,264) |
| Transfers out of Level 3 | - | - | - | - | - | - | - |
| Transfers into Level 3 | - | - | 28,449 | - | - | - | 28,449 |
| Balance, end of period | <u>\$ 184,289</u> | <u>\$ 109,852</u> | <u>\$ 149,111</u> | <u>\$ 2,380</u> | <u>\$ 21,573</u> | <u>\$ 712</u> | <u>\$ 467,917</u> |

At December 31, 2015, alternative investments recorded at NAV consisted of the following (in thousands):

| | Fair Value | Unfunded Commitments | Redemption Frequency if Currently Eligible | Redemption Notice Period |
|---|-------------------|-------------------------|--|--------------------------------|
| Equity long/short hedge funds ^a | \$ 33,593 | \$ - | quarterly, annually | 60-90 days |
| Event driven investments ^b | 99,567 | - | quarterly, annually | 30-90 days |
| Relative value investments ^c | 86,145 | - | monthly, quarterly | 30-90 days |
| Tactical trading investments ^d | 140,743 | - | daily, monthly | 2-90 days |
| Risk parity ^e | 177,885 | - | monthly | 5-30 days |
| Real estate funds - open ended ^f | 63,556 | - | quarterly | 90 days |
| Real estate funds - close ended ^g | 46,296 | 1,023 | | |
| Group mortgage loan and real estate fund ^h | 381 | - | | |
| Oil and gas funds ⁱ | 276 | - | | |
| Private equity funds ^j | <u>184,289</u> | <u>119,665</u> | | |
| Total | <u>\$ 832,731</u> | <u>\$ 120,688</u> | | |

- a) Equity long/short strategy involves managers buying long equities that are expected to increase in value and selling short equities that are expected to decrease in value. Typically, equity long/short investing is based on stock by stock fundamental analysis of the individual companies, in which investments are made. There may also be an overall analysis of the risks and opportunities offered by industries, sectors, countries, and the macroeconomic situation. Long/short covers a wide variety of strategies. There are generalists, and managers who focus on certain industries and sectors or certain regions. Managers may specialize in a category - for example, large cap or small cap, value or growth. There are many trading styles, with frequent or dynamic traders and some longer-term investors. Returns are generally more correlated with the direction of the equity markets, although reduction in market risk exposure

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

through shorting is expected to enhance the absolute and risk-adjusted returns relative to the overall performance of the asset class. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.

- b) Event-driven investing is a strategy which seeks to exploit pricing inefficiencies that may occur before or after a corporate event, such as an earnings call, bankruptcy, merger, acquisition, or spinoff. Returns are less correlated with the general direction of market movements primarily due to the idiosyncratic nature of individual events. Several investment managers include quarterly percentage redemption limits. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- c) Relative value strategies are designed to focus on large, long-term mispricing in the global fixed-income, equity and credit markets, capturing relative-value anomalies via multi-product trades. Returns are relatively uncorrelated with the general direction of market movements since they avoid taking a directional bias with regards to the price movement of a specific stock or market. Several investment managers include quarterly percentage redemption limits and/or early redemption penalties. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- d) Tactical trading strategies generally invest on a large scale around the world using economic theory to justify the decision making process on either a discretionary or systematic basis. Strategies are typically based on forecasts and analysis about interest rates trends, the general flow of funds, political changes, government policies, inter-government relations, and other broad systemic and technical factors. Returns are relatively uncorrelated with the general direction of market movements. Several investment managers include quarterly percentage redemption limits. The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- e) The risk parity class strategy invests across global markets including equities, nominal government bonds, inflation linked bonds, commodities, and emerging markets on a risk balanced framework. Typically these strategies incorporate leverage to increase the risk contribution from low volatility asset classes (e.g., inflation linked bonds and nominal government bonds). The fair values of the investments in this class have been estimated using the net asset value per share of the funds.
- f) The real estate funds – open ended class includes a real estate fund that invests in U.S. commercial real estate. The fair values of the investments in this class have been estimated using the net asset value, which is based on the ownership interest of the partners' capital. Redemptions are available on a quarterly basis, subject to the discretion of the General Partners. The General Partners may elect to establish a redemption queue should the level of redemptions for a given quarter be detrimental to the fund's overall performance.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

- g) The real estate funds- close ended class includes several real estate funds that invest primarily in U.S. commercial real estate and industries related to real estate, with some having minimal exposure outside of the U.S. The fair values of the investments in this class have been estimated using the net asset value, which is based on the ownership interest of partners' capital. These partnerships are illiquid and therefore do not have a redemption feature. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of these funds will be liquidated over the next six years with the value of those underlying assets being replaced by investments in new real estate funds.
- h) The group mortgage loan and real estate class is primarily invested in real estate and loans secured by real estate located in the Dallas/Fort Worth area. The fair value of the investments have been estimated based on internal appraisals using the fund management's knowledge of the properties, current real estate market for similar properties and recent sales of comparative properties. This fund is illiquid and redemption is subject to fund management approval. Distributions from the fund will be received as the underlying investments are liquidated. It is estimated that the underlying assets of the fund will be liquidated over the next 2 to 10 years. This fund is closed to new investors.
- i) The oil and gas class is primarily invested in mineral properties located in Texas and Wyoming. The fair value of the mineral properties have been estimated by multiplying the most recent twelve months of royalty income, excluding lease bonus income, times a factor of four. The fund's management used a multiple of four for the valuation based on current industry methodology, recent market transactions, and the fund's extensive experience in mineral properties. This fund is illiquid and redemption is subject to fund management approval. Royalty income is distributed quarterly subject to fund management approval (\$0.825 per unit per quarter in 2015). Distributions from the fund will be received as the underlying investments are depleted. This fund is closed to new investors.
- j) The private equity class currently includes 39 unique private equity limited partnerships that each invest in a variety of mostly private companies. These investments have a drawdown structure where a portion of commitments (which are made upon entering the partnership) are called gradually over the first 3-6 years of the partnership's life. It is expected that most of the unfunded commitments should be called within the next 6 years. These partnerships are illiquid and therefore do not have a redemption feature. Instead, the nature of the investments in this class is that distributions are received as the investment in the underlying companies are sold. It is estimated that the current underlying assets of these partnerships should be liquidated within the next 10 years. The investments are valued based on each partnership's valuation policy which is then subject to annual third party financial audits. Financial audits are available approximately 90 days following year end. Therefore, the valuation at year end reflects the latest reported manager valuation with adjustments for new capital calls and distributions.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

4. ENDOWMENTS

The System's endowments consist of donor-restricted and board-designated endowment funds for a variety of purposes. The net assets associated with endowment funds are classified and reported based on the existence or absence of donor imposed restrictions.

The System has interpreted the State of Texas Uniform Prudent Management of Institutional Funds Act (UPMIFA) as not requiring the maintaining of purchasing power of permanently restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the System classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the System considers the following factors in making a determination to appropriate or accumulate endowment funds:

- 1) The duration and preservation of the fund
- 2) The purposes of the System and the donor restricted endowment fund
- 3) General economic conditions
- 4) The possible effect of inflation and deflation
- 5) The expected total return from income and the appreciation of investments
- 6) Other resources of the System and
- 7) The investment policies of the System.

Return Objectives and Risk Parameters

The System follows an investment policy that attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return against various indices, based on the endowment's target allocation applied to the appropriate individual benchmarks.

To achieve its long-term rate of return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The System targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

Relationship of Endowment Spending Practices to Investment Objectives

The System determines the appropriation of endowment funds for expenditure reimbursement through the budgeting process. Distribution policies for the System's endowments govern the amount of endowment funds that may be appropriated during this process. In establishing its policies, the System considered the long-term expected return on its endowments. Accordingly, over the long-term, the System expects the current distribution policies to allow its endowments to grow at an average of the long-term rate of inflation and maintain its purchasing power. In order to maintain the purchasing power of endowment assets, expenditures are based on investment performance and spending is curbed in response to deficit situations. Over the long term, the System expects its endowment to grow consistent with its intention to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts.

5. NET PATIENT CARE REVENUE

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per case, reimbursed costs, discounted charges, and per diem payments. Net patient care revenue (exclusive of charity care – see Note 6) is recognized at the time service is rendered and is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated contractual adjustments under reimbursement agreements with third-party payors.

Contractual adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. These contractual adjustments are related to the Medicare and Medicaid programs and managed care contracts. The System offers a discount to uninsured patients.

Federal Regulations require the submission of annual cost reports covering medical costs and expenses associated with services provided to program beneficiaries. Medicare and Medicaid cost report settlements are estimated in the period services are provided to beneficiaries. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimates may change by a material amount as interpretations are clarified and cost reports are settled.

6. CHARITY CARE

The System provides care to patients who lack financial resources and are deemed medically or financially indigent. Because the System does not pursue collection of amounts determined to qualify as charity care, these amounts have been removed from net patient care

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

revenue as described in Note 5. In addition, the System provides services through government-sponsored indigent health care programs (such as Medicaid) to other indigent patients.

The System also commits time and resources to endeavors and critical services which meet otherwise unfulfilled community needs. Many of these activities are entered into with the understanding that they will not be self-supporting or financially viable.

7. RETIREMENT BENEFITS

Retirement

ASC 715, "*Compensation - Retirement Benefits*," requires the System to recognize the funded status (i.e., the difference between the fair value of plan assets and the benefit obligation) of its defined benefit pension and other postretirement benefit plans in the accompanying combined balance sheets with a corresponding adjustment to unrestricted net assets. The net unrecognized actuarial losses and unrecognized prior service benefits are recognized as a component of future net periodic cost pursuant to the System's policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods are recognized as other changes in unrestricted net assets. Those amounts are recognized as a component of net periodic cost.

The System provides 401(k) defined contribution plans for eligible employees. Employees are eligible to contribute to the plan immediately with no minimum service or age requirement.

BHCS and six of its affiliated hospitals provided a defined benefit plan, the Baylor Health Care System Retirement Security Plan (the "BEST Plan"), for employees, which was discontinued on January 1, 1984.

All Saints Health System provided a defined benefit plan, the All Saints Health System Pension Plan (the "All Saints Plan"), for employees of All Saints, which was frozen to future benefit accruals as of January 1, 2002, with the All Saints Health System purchase by BHCS.

King's Daughter Hospital provided a defined benefit plan, the Texas Hospital Association Retirement Plan for King's Daughters (the "King's Daughters Plan"), for employees of King's Daughters Hospital, which was frozen to future benefit accruals as of March 31, 2009, with the King's Daughters Hospital purchase by Scott & White.

Scott & White Hospital-Brenham provided a defined benefit plan, the Texas Hospital Association Defined Benefit Retirement Plan for Scott & White Hospital-Brenham (the

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

“Brenham Plan”), for employees of Scott & White Hospital-Brenham, which was frozen to future benefit accruals as of June 30, 2010, with the Brenham Hospital purchase by Scott & White.

Certain Scott & White employees participate in Scott & White’s medical postretirement benefit plan. This plan provides medical and dental benefits to retirees who meet specific eligibility requirements upon retirement. The plan is unfunded and requires covered retirees to contribute a portion of the cost of benefits based on age at retirement and years of service.

Scott & White uses an incremental cost approach in estimating the annual accrued cost related to the postretirement benefit plan, which is based on estimates by independent actuaries. Such an approach is considered appropriate since substantially all of the health care benefits are provided by Scott & White to retirees, using the Health Plan to manage the care provided.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 introduced a prescription drug benefit under Medicare (Medicare Part D), as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Scott & White has not made the determination that the prescription drug benefit provided by its medical postretirement benefit plan is actuarially equivalent to the benefit provided by Medicare Part D. Therefore, the measures of the accumulated benefit obligation or net periodic benefit cost do not reflect any amounts associated with the federal subsidy.

8. COMMITMENTS AND CONTINGENCIES

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, physician ownership and self-referral, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the System is in compliance with applicable fraud and abuse laws and regulations as well as other applicable federal and state laws and regulations.

Irving

The Irving Hospital Authority (“Authority”) entered into a Master Agreement (“Master Agreement”) with Baylor Medical Center at Irving (Irving) and BHCS and a Lease Agreement (“Lease Agreement”) with Irving.

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

Under the terms of the Lease Agreement, Irving agreed to manage and lease substantially all properties of the Authority over an initial lease term of 20 years, beginning August 1, 1995, with an option to renew the lease for two additional 10 year terms. An Amended and Restated Lease Agreement (“Amended Lease Agreement”) was entered into by the Authority and Irving effective April 1, 2010, to extend the lease thirty five years through March 31, 2045, and to supersede nearly all the obligations of the original Master Agreement and Lease Agreement.

The Amended Lease Agreement is accounted for as a capital lease with (a) fixed rent payments of approximately \$8,825,000 per year, as adjusted by a September 24, 2010 amendment to the Amended Lease Agreement, plus (b) a contingent rent payment equal to 20.0% of the excess operating cash flow derived from the prior fiscal year’s operations, as defined in the Amended Lease Agreement.

BHCS signed a Limited Joinder to evidence its agreement with the BHCS obligations included in the Amended Lease Agreement and to covenant that BHCS will pay the rent and the early termination fee/liquidated damages if Irving fails to pay those obligations. During the initial six year term of the Revised Lease Agreement, Irving pays BHCS a management fee, based on a percentage of the excess operating cash flow, as defined in the Revised Lease Agreement. BHCS continues to be required to contribute \$100,000 per year to Irving, to be matched by the Irving Healthcare Foundation, for community health projects, which are mutually agreed upon by BHCS and Irving. At the end of the lease term the leased facilities will be surrendered to the Authority. At December 31, 2015 and June 30, 2015, no liability under the Revised Lease Agreement was recorded as no amount can be reasonably estimated.

9. NONCONTROLLING INTERESTS

The System controls and therefore consolidates certain investees of its subsidiaries. The System regularly engages in the purchase and sale of noncontrolling interests in these investees that do not result in a change of control. These transactions are accounted for as equity transactions as they are undertaken among the System, its consolidated subsidiaries, and noncontrolling interests, and their cash flow effect is classified within financing activities. The System reflects noncontrolling interests in subsidiaries as either noncontrolling interests - redeemable in the mezzanine section of the accompanying combined balance sheets, or noncontrolling interests - nonredeemable in net assets in the combined balance sheets, according to ASC 810, “*Consolidations.*”

BAYLOR SCOTT & WHITE HOLDINGS AND ITS CONTROLLED AFFILIATES

Notes to Combined Financial Statements (Unaudited) - continued

10. SUBSEQUENT EVENTS

Tenet Transaction

In January 2016, the System and Tenet Healthcare Corporation (“Tenet”) entered into two joint ventures to provide care through five North Texas hospitals. The joint ventures will focus on delivering integrated, value-based care to communities in Rockwall, Collin and Dallas counties. Through these new joint ventures, the two organizations will jointly own Centennial Medical Center, Doctors Hospital at White Rock Lake, Lake Pointe Medical Center, Texas Regional Medical Center at Sunnyvale and Baylor Scott & White Medical Center - Garland. The System will hold a majority ownership interest in the entities operating the five hospitals, and all five will eventually operate under the Baylor Scott & White Holdings And Its Controlled Affiliates brand. An advance payment of approximately \$288,810,000 was made related to this transaction at December 31, 2015 and was recorded in other current assets in the accompanying combined balance sheets.

Interest Rate Swaps

On January 15, 2016, the fixed swap rate payments and variable rate swap receipts on eleven swaps originally structured between BHCS and various swap counterparties were reactivated.

The payments under the eleven swaps had been suspended since February 2013. A of these swaps were novated to BSW Holdings in July 2014. BSW Holdings and its controlled affiliates have been and continue to be subject to the collateral posting requirements under the referenced swaps.

The Heart Hospital Baylor Denton

Texas Heart Hospital of the Southwest, LLP purchased The Heart Hospital Baylor Denton, land and building, currently recorded as a capital lease in the accompanying combined balance sheets, on January 26, 2016 for approximately \$25,000,000.

The System has performed an evaluation of subsequent events through March 24, 2016, which is the date the financial statements were issued.

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APPENDIX C

**DEFINITIONS OF CERTAIN TERMS
AND SUMMARIES OF PRINCIPAL DOCUMENTS**

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GENERAL DEFINITIONS

Capitalized terms not otherwise defined in the Official Statement or under this caption have the meanings ascribed to them in the Bond Indenture, the Loan Agreement and the Master Indenture.

“**Accounts**” means, collectively, all accounts (as such term is defined in Article 9 of the Uniform Commercial Code), accounts receivable, other receivables, contracts, contractual rights, tax refunds, or other obligations or indebtedness of any kind or description owing to an Obligated Affiliate, secured or unsecured, now or hereafter existing, whether or not arising out of or in connection with the payment for goods sold or leased or services rendered, whether or not earned by performance, and all sums of money or other proceeds due or becoming due thereon, together with all rights now or hereafter existing under guarantees and collateral security therefor and under leases and other contracts securing, guaranteeing, or otherwise relating to any of the foregoing, including without limitation (a) all rights to receive any performance or any payments in money or in kind; (b) all right, title, and interest in and to the goods, services, or other property that give rise to or that secure any of the foregoing, and insurance policies and proceeds thereof relating thereto; (c) all rights as an unpaid seller of goods and services including without limitation all rights of stoppage in transit, replevin, reclamation, and resale; (d) all rights to receive any Medicare/Medicaid Receivables or payments under any other federal programs or state and local governmental programs providing for the payment of or reimbursement for services rendered or under private insurance programs (including without limitation prepaid health organizations, health maintenance organizations or preferred provider organizations), in each case only to the extent not prohibited by applicable law; (e) reversionary interests in pension and profit-sharing plans, and reversionary, beneficial, and residual interest in trusts, and credits with and any other claims against any Person; and (f) all ledger sheets, files, records, and documents relating to any of the foregoing, including all computer records, programs, storage media, and computer software used or required in connection therewith.

“**Affiliate**” of any specified Person means any other Person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified Person. For purposes of this definition, “**control**” when used with respect to any specified Person means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract, or otherwise; and the terms “**controlling**” and “**controlled**” have meanings correlative to the foregoing.

“**All Saints**” means Baylor All Saints Medical Center, a Texas nonprofit corporation.

“**Annual Debt Service Requirements**” of any Persons for any Fiscal Year means the principal of (and premium, if any) and interest and other debt service charges on all Outstanding Debt of such Persons coming due at the Stated Maturity of such Debt or at any Stated Maturity of the interest thereon in such Fiscal Year, and, for such purposes, any one or more of the following rules shall apply at the election of the Combined Group Representative:

(A) **Committed Take-Out:** If any such Person has received a line of credit or loan or other commitment, binding to the degree which is customary in normal commercial practice, from any bank, savings and loan association, insurance company, or similar institution to refund, purchase, or otherwise directly or indirectly refinance any of its Debt at the Stated Maturity or Maturity thereof (or, if due, or payable in respect of any required purchase of such Debt, on demand, at any date on which demand may be made), then the portion of the principal of and premium, if any, and interest and similar charges committed to be refunded shall be excluded from such calculation and the principal of and premium, if any, and interest (at the fixed rate, if any, stated in such commitment or, if the rate stated therein is variable, at the lesser of the rate established pursuant to *Clause (C)* of this definition or the maximum rate, if any, stated in such commitment) on the refunding Debt which would be due in the Fiscal Year for which the calculation is being made, if incurred at the maturity of the Debt to be refunded, shall be added.

(B) **Balloon and Demand Debt:** If the amount of any Debt which is due, or at the option of the payee could become due or payable in respect of any required purchase of such Debt, in such Fiscal Year (after taking into account the amortization thereof pursuant to any required sinking fund) exceeds 15% of the original amount of such Debt and the Combined Group Representative shall deliver to the Master Trustee:

(1) *Refinancing Certificate*: an Officer's Certificate, dated within 90 days of the date of calculation of such Annual Debt Service Requirements, stating that financing of a stated term (which shall not extend beyond 30 years after such date of calculation), amortization, and interest rate is reasonably attainable to refund or otherwise directly or indirectly to refinance any amount of such Debt, then the principal of and premium, if any, and interest and other debt service charges on the amount of such Debt so certified to be refundable or refinanceable shall be excluded from such calculation and the principal of and premium, if any, and interest and other debt service charges on the refunding Debt as so certified which would result from such refunding or refinancing in such Fiscal Year, if incurred on the first day of the Fiscal Year for which Annual Debt Service Requirements are being calculated, shall be added; or

(2) *Sinking Fund Retirement*: a Consent of the obligor on such Debt agreeing to retire (and such Debt shall permit the retirement of), or to fund a sinking fund for, the principal of such Debt according to a fixed schedule stated in such consent ending on or before the Fiscal Year in which such amount is due or could become due or payable in respect of any required purchase of such Debt, then the principal of (and, in the case of retirement, the premium, if any, and interest and other debt service charges on) such Debt shall be computed as if the same were due in accordance with such schedule; *provided* that this *Clause (2)* shall apply only to Debt for which the installments of principal previously scheduled have been paid or funded on or before the times required by such schedule.

(C) *Variable Rate Debt*: As to any Debt which bears interest at a variable rate which cannot be ascertained at the time of calculation, for any balance of such Debt to which *Clause (D)* does not apply, either of the following shall be presumed to apply for all future dates at the election of the Combined Group Representative: (1) the average rate thereon during any 12-month period ending within 30 days prior to the date of calculation (or such lesser time as such Debt has been Outstanding), or (2) the average rate of a comparable variable rate interest index during any 12-month period ending within 30 days prior to the date of calculation (or such lesser time as such index has been determined) as selected by the Combined Group Representative and as set forth in an Officer's Certificate of the Combined Group Representative.

(D) *Hedged Debt*: if any Person is a party to a Financial Hedge relating to any Debt:

(1) *Swapped Rate*: under which it is obligated to pay an amount calculated at a fixed rate or a floating rate in such Fiscal Year, and has the right to receive in such Fiscal Year an amount calculated at a floating rate or a fixed rate that bears, in the judgment of the Combined Group Representative, a close correlation to the interest rate on such Debt, in each case computed with respect to a notional amount that does not exceed the principal amount of such Debt, then an amount of such Debt equal to such notional amount will be deemed to bear interest at the fixed rate or floating rate paid by such Person for such Fiscal Year; *provided* that for purposes of computing a floating rate under this *Clause (D)(1)* for any future Fiscal Year, such floating rate shall be computed in accordance with the immediately preceding *Clause (C)(1)*; or

(2) *Cap/Floor Rate*: under which it has the right to receive in such Fiscal Year an amount calculated at any excess of the interest rate on such Debt (or any closely correlated interest rate index) over a specified rate (herein referred to as the "*cap rate*"), or is obligated to pay in such Fiscal Year an amount calculated at any excess of a specified rate (herein referred to as the "*floor rate*") over the interest rate on such Debt (or any closely correlated interest rate index), in each case computed with respect to a notional amount that does not exceed the principal amount of such Debt, then an amount of such Debt equal to such notional amount will be deemed to bear interest at (i) the cap rate in such Fiscal Year whenever the rate of such Debt, computed in accordance with the immediately preceding *Clause (C)*, exceeds the cap rate, and (ii) the floor rate in such Fiscal Year whenever the rate of such Debt, computed in accordance with the immediately preceding *Clause (C)*, is less than the floor rate.

(E) *Guarantees*: So long as a Person (the "*Guarantor*") has not made within the two most recent Fiscal Years a payment required by and pursuant to any guarantee or similar obligation made by the Guarantor for the payment or purchase of Debt of another Person (the "*Guaranteed Person*"), there shall be excluded from the Debt of the Guarantor the Debt of the Guaranteed Person that is guaranteed by the Guarantor (or as to which the Guarantor is otherwise obligated to make payments or purchase). In addition, and regardless of whether or not a Guarantor has made a payment under a guaranty within the two most recent Fiscal Years, there shall be excluded from the Debt of any Guarantor (i) any Debt guaranteed if the Guarantor's financial information is reflected in the

financial statements of the Guaranteed Person and the Guaranteed Person's Debt so guaranteed is included in the calculation of Annual Debt Service Requirements, and (ii) any Debt guaranteed if the payment of such Debt has also been guaranteed or otherwise assured by a letter of credit, insurance policy or guarantee from an institution the long term debt of which has a rating assigned to it by a Rating Agency at least as high as the rating on the long term debt of the Guarantor (or, if the Guarantor is a Member of the Combined Group, the rating of the Senior Master Debt) immediately prior to the delivery by such institution of its letter of credit, insurance policy or guarantee.

(F) *Economically Defeased Debt and Trustee Held Funds:* The principal of (and premium, if any) and interest and other debt service charges on any Debt that are or could become due or payable in respect of any required payment or purchase of such Debt shall be excluded from the calculation of Annual Debt Service Requirements to the extent such amounts are payable from funds or securities irrevocably deposited or set aside in trust or escrowed for such purpose from the proceeds of Debt (including accrued or capitalized interest) or income from the investment thereof or from any other funds.

(G) *Redeemed or Refunded Debt:* If arrangements have been made for the redemption or payment of any amount of principal of (and premium, if any) and interest and other debt service charges on any Debt which is then Outstanding or treated as Outstanding under this definition with proceeds of other firmly committed Debt or other committed sources of money (including any commitment by any Person to make payments under a Financial Hedge), then the principal of (and premium, if any) and interest and other debt service charges to be refinanced or paid by such firmly committed Debt or by such other committed money shall be ignored for purposes of such calculation, and any such firmly committed Debt shall be treated as Outstanding Debt with terms as set forth in the related loan commitment.

(H) *Maturing Debt:* If any Debt has a Stated Maturity or Maturity within four years of the date of calculation of Annual Debt Service Requirements and the Combined Group Representative delivers to the Master Trustee an Officer's Certificate, dated within 90 days of the date of such calculation, stating that (i) the obligor on such Debt anticipates redeeming or refunding any amount of principal of (and premium, if any) and interest and other debt service charges on such Debt with proceeds of other Debt, and (ii) the issuance on or before such Stated Maturity or Maturity of Debt for such purpose with a stated term (which shall not extend beyond 20 years after such date of calculation), amortization, and interest rate is reasonably attainable, then for purposes of such calculation, the amount of principal of (and premium, if any) and interest and other debt service charges maturing shall be ignored and the principal of (and premium, if any) and interest and other debt service charges on the Debt described in *Clause (ii)* of this *Clause (H)*, as if issued at the Stated Maturity or Maturity of the principal so ignored, shall be added.

"Application" means an application for the qualification of a promissory note, draft, bond, or guaranty under the Master Indenture as Master Debt signed in the name of the Combined Group Representative by an authorized officer and delivered to the Master Trustee, and no Application shall be deemed complete until there shall have been delivered to the Master Trustee such documents as are required under the Master Indenture to have such note, draft, bond, or guaranty so qualified. The date of an Application shall be deemed to be the date of completion of all such deliveries to the Master Trustee and not the date on any particular document so delivered.

"Bank Accounts" means all deposit accounts (as such term is defined in Article 9 of the Uniform Commercial Code) and shall include, without limitation, all checking, investment, or deposit accounts (general or specific, time or demand, provisional or final) at any time maintained by any Obligated Affiliate, including without limitation accounts to which collections of Medicare/Medicaid Receivables are deposited, and all moneys, securities, instruments, general intangibles, and investment property (as such term is defined in Article 9 of the Uniform Commercial Code) deposited or held therein, *but only* to the extent the granting, assignment, or pledge thereof is not prohibited by applicable law.

"BHCS" means Baylor Health Care System, a Texas nonprofit corporation.

"Bond Fund" means the fund of the Issuer described in this Appendix C under the caption **"THE BOND INDENTURE—Funds Under the Bond Indenture—Bond Fund."**

“**Bond Register**” means the register caused to be maintained by the Issuer to provide for the registration and transfers of Bonds.

“**Bondholder**” means a Holder of a Bond and, when used in the Bond Indenture, also means, while Bonds are registered in the name of the Securities Depository, any Person who claims to be a beneficial owner of Bonds by written statement given to the Bond Trustee providing the address of such Person and requesting that notices be given to such Person.

“**Bonds**” means the Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds (Baylor Scott & White Health Project) Series 2016A.

“**Borrower**” or “**BSW Holdings**” means Baylor Scott & White Holdings, a Texas nonprofit corporation, *until* a successor shall have assumed the rights and obligations of the “**Borrower**” under the Loan Agreement pursuant to the applicable provisions thereof; thereafter “**Borrower**” shall mean such successor corporation.

“**Borrower Consent**,” “**Borrower Order**,” and “**Borrower Request**” mean, respectively, a written consent, order, or request signed in the name of the Borrower by an officer of the Borrower and delivered to the Issuer and the Trustee.

“**BSW Health**” means Baylor Scott & White Health, a Texas nonprofit corporation.

“**BUMC**” means Baylor University Medical Center, a Texas nonprofit corporation.

“**Cash Proceeds**” means proceeds that are money, checks, deposit accounts, or the like.

“**Code**” means the Internal Revenue Code of 1986, as amended and in force and effect on the Issue Date.

“**College Station**” means Scott & White Hospital – College Station, a Texas nonprofit corporation.

“**Combined Group**” means collectively all Obligated Affiliates and all Restricted Affiliates.

“**Combined Group Financial Statements**” means (i) any special purpose financial statements including only Members of the Combined Group, or (ii) the financial information relating solely to the Combined Group as shown on the consolidating schedule contained in any System Financial Statements.

“**Combined Group Representative**” means the Person so designated under the Master Indenture, and is currently BSW Holdings.

“**Consent**,” “**Order**,” and “**Request**” mean, respectively, a written consent, order, or request signed in the name of the Borrower by an officer of the Borrower and delivered to the Issuer and the Trustee.

“**Consolidated Net Revenues**” for a group of Persons means the combined Net Revenues as reflected in the Financial Statements of such Persons, adjusted to eliminate intercompany items among any such Persons whose financial information is combined in such Financial Statements.

“**Continuing Care Hospital**” means Scott & White Continuing Care Hospital, a Texas nonprofit corporation.

“**Contract Rights**” means all rights of any Obligated Affiliate in and to contracts to which any such Person is now or shall become a party and pursuant to which such Person has the right to perform medical and/or management services and receive payment, reimbursement, insurance proceeds, or any other form or manner of compensation, including without limitation the Medicare and Medicaid reimbursement agreements to which such Person is a party and any and all other agreements and/or arrangements between such Person and a governmental or quasi-governmental entity pursuant to which such Person provides such healthcare services and receives any form of payment, and any other agreements pursuant to which such Person provides healthcare services on a reimbursed,

capitated, or other form of payment arrangement, *but only* to the extent the granting, assignment, or pledge thereof is not prohibited by applicable law.

“**Controlling Master Debt**” means (a) so long as any Senior Master Debt is then Outstanding, the Outstanding Senior Master Debt, and (b) if no Senior Master Debt is then Outstanding, the Outstanding Subordinate Master Debt.

“**Cost**” when used with respect to a Project means and includes any and all costs of such Project and, without limiting the generality of the foregoing, shall include:

(1) the cost of the acquisition of land, rights-of-way, options to purchase land, easements, leasehold estates in land, and other interests in land related to such Project,

(2) the cost of the acquisition, construction, repair, renovation, remodeling, or improvement of structures used as, or in conjunction with, such Project,

(3) the cost of site preparation, including demolition or removal of structures as necessary or incident to providing such Project,

(4) the cost of architectural, engineering, legal, and other related services,

(5) preparation costs of plans, specifications, studies, surveys, and cost and revenue estimates and other expenses necessary or incident to planning, providing, or determining the feasibility of such Project,

(6) the cost of machinery, equipment, furnishings, and facilities necessary or incident to placing such Project in operation,

(7) finance charges, interest, and marketing and start-up costs related to such Project before and during construction and for not more than two years after the date that construction is completed,

(8) costs incurred in connection with financing such Project, including (a) the expenses, costs, and compensation described in the Bond Indenture, (b) financing, legal, accounting, financial advisory, and appraisal fees, expenses, and disbursements, (c) the cost of any policy or policies of title insurance, (d) the cost of printing, engraving, and reproduction services, and (e) the cost of the initial or acceptance fee of any trustee or paying agent, and

(9) costs of the Issuer incurred in connection with providing such Project, including reasonable amounts to reimburse the Issuer for time spent by its agents or employees relating to providing such Project and the financing thereof.

“**Current Value**” of any property of any Person means the appraised value of such property, established by an Officer’s Certificate of such Person, for which an appraisal (dated not more than three years preceding the date such Officer’s Certificate is delivered to the Master Trustee) is attached to such Officer’s Certificate.

“**Debt**” of any Person at any date shall include all obligations that would be included in determining total liabilities as shown on the liabilities side of a balance sheet of such Person in accordance with the Master Indenture, *excluding, however*, any reserves for estimated obligations, deferred income, the value of Financial Hedges, and offsets to asset values, all as recorded in accordance with generally accepted accounting principles, and shall include:

(1) **Guarantees**: all indebtedness guaranteed, directly or indirectly, in any manner by such Person, or in effect guaranteed, directly or indirectly, by such Person through an agreement, contingent or otherwise, to purchase indebtedness or to advance or supply funds for the payment or purchase of indebtedness or to purchase property or services primarily for the purpose of enabling the debtor or seller to make payment of indebtedness or to assure the owner of the indebtedness against loss, or to supply funds to or in any other manner invest in the debtor

(including any agreement to pay for property or services irrespective of whether or not such property is delivered or such services are rendered), or otherwise,

(2) **Subject to Debt:** all indebtedness secured by any mortgage, lien, pledge, charge, or encumbrance upon property owned by such Person even though such Person has not assumed or become liable for the payment thereof,

(3) **Conditional Sales Agreement:** all indebtedness of such Person created or arising under any conditional sale or other title retention agreement with respect to property acquired by such Person even though the rights and remedies of the seller or lender under such agreement in the event of default are limited to repossession or sale of such property,

(4) **Synthetic Leases:** all leases to such Person or other agreements for the possession or use of property by such Person that, in either case, include an obligation of such Person that either (a) is a residual guaranty within the meaning of Financial Accounting Statement No. 13 (Accounting for Leases) issued by the Financial Accounting Standards Board or (b) would be treated as an indebtedness of such Person in a proceeding by or against such Person, as debtor, under the United States Bankruptcy Code, which leases and agreements shall be deemed to be in the amount which would be shown as a liability on the balance sheet of such person prepared in accordance with generally accepted accounting principles if such leases and agreements were accounted for as capital leases,

(5) **Recast Sales:** any sale of property subject to an operating lease, or sale of property that is leased by or intended to be leased by the third-party purchaser to another party, where the seller or any party related to the seller retains substantial risks of ownership in the leased property and such transaction is not treated as a sale in accordance with generally accepted accounting principles and instead is shown as a liability on the balance sheet of such Person, and

(6) **Recourse for Receivables:** any obligation of any Person to repurchase accounts receivable of such Person,

As a limitation to the foregoing definition, “*Debt*” does not include:

(a) **Taxes, Etc.:** accrued liabilities for taxes, assessments, and governmental charges or levies and claims for labor, materials, and supplies,

(b) **Dividends and Allocations:** debt represented by dividends or distribution of earnings declared but not paid,

(c) **Ordinary Course Payables:** current liabilities incurred in the ordinary course of business or for contributions to self-insurance or other risk management programs which do not represent indebtedness for borrowed money,

(d) **Guarantees of Certain Excluded Debt:** any indebtedness that directly, indirectly, or in effect guarantees any debt or obligation described in *Clause (a), (b), or (c)* immediately above,

(e) **Guarantees of Combined or Consolidated Debt:** indebtedness of an entity that is based upon the guarantee or assumption by such entity, directly or indirectly, of indebtedness of another entity, both of whose financial information is combined or consolidated in the same financial statements,

(f) **Combined or Consolidated Capital Leases:** capital leases shown on the liabilities side of the balance sheet of a Person, *but only if* (i) such Person is not a party to such lease, and (ii) such Person has no direct responsibility for any payments under such lease, and

(g) **Redeemable Noncontrolling Interests:** shares, membership interests, or any other evidences of ownership in a Person that constitute a noncontrolling interest in such Person and are classified as a liability due to the redemption, call, or put features of such shares, membership interests, or other evidences of ownership,

and *provided*, to the extent that a Person has obtained credit or liquidity enhancement or support for Debt, whether by means of a bank bond purchase agreement, letter of credit, revolving credit agreement, surety bond, or otherwise, and the terms and conditions under which such credit or liquidity enhancement or support was obtained require such Person to reimburse the provider of such enhancement or support, such obligation of such Person to reimburse such provider for such amounts shall constitute Debt only when and to the extent such advances are actually made and such obligation to reimburse actually arises.

“**Debt Service Coverage Ratio**” for any Fiscal Year means the quotient obtained by dividing (1) the Consolidated Net Revenues of the System or the Combined Group as reflected in the System Financial Statements or the Combined Group Financial Statements, respectively, for such Fiscal Year by (2) the Maximum Annual Debt Service Requirements of the System or the Combined Group, respectively, all as established in accordance with and pursuant to the Master Indenture; *provided* that if the Financial Statements that would be used to calculate Consolidated Net Revenues under *Clause (1)* of this definition cover a period consisting of fewer than 12 months, then at the election of the Combined Group Representative either (i) the Maximum Annual Debt Service Requirements under *Clause (2)* of this definition shall be pro rated to reflect such shorter period, or (ii) Consolidated Net Revenues under *Clause (1)* of this definition shall be based on financial statements of the System or the Combined Group covering a consecutive 12-month period selected by the Combined Group Representative that ends within 180 days preceding the date of calculation of the Debt Service Coverage Ratio, and such consecutive 12-month period shall be deemed to be a Fiscal Year for purposes of such calculation of the Debt Service Coverage Ratio.

“**Default**” means the occurrence of an Event of Default or an event which, after notice or lapse of time or both, would become an Event of Default. A Default shall “*exist*” if a Default shall have occurred and be continuing.

“**Eligible Investments**” under the Bond Indenture means any of the following securities:

A. Governments: both (i) direct obligations of, or obligations the timely payment of principal of and interest on which are fully and unconditionally guaranteed by, the United States of America, including Treasury Receipts and STRIPS (Separate Trading of Registered Interests in Principal of Securities) held for the account of the Bond Trustee by a custodian, and (ii) evidences of ownership of proportionate interests in future interest and principal payments on direct and general obligations of the United States of America, if (x) a bank or trust company holds the underlying obligations as custodian, (y) the owner of the investment is the real party in interest and has the right to proceed directly and individually against the obligor on the underlying obligations, and (z) the underlying obligations are held by the custodian in a special account, segregated from its general assets, and are not available to satisfy any claim of the custodian, any Person claiming through the custodian, or any person to whom the custodian may be obligated;

B. Full Faith Agencies: bonds, debentures, notes, or other evidences of indebtedness issued, created, or guaranteed by any of the following agencies (or divided interests therein created by such agency itself), if at the time of their purchase such obligations are backed by the full faith and credit of the United States of America: Federal Financing Bank; Export-Import Bank of the United States; Farmers Home Administration; General Services Administration; Government National Mortgage Association; U.S. Maritime Administration; and United States Department of Housing and Urban Development;

C. Government Agencies: bonds, debentures, notes, or other evidences of indebtedness issued, created, or guaranteed by any of the following governmental agencies (or divided interests in such securities created by such agency itself): Federal Home Loan Bank System; Federal Home Loan Mortgage Corporation; Federal National Mortgage Association; Student Loan Marketing Association; Resolution Funding Corp.; and Farm Credit System;

D. Municipals: obligations issued or incurred by or on behalf of any state of the United States of America or any political subdivision or municipality thereof, if at the time of their purchase such obligations are rated by S&P and Moody’s, or, upon the discontinuance of either or both of such services, such other nationally recognized rating service as shall be determined by Borrower Order, in one of the two highest whole letter rating categories of such Person;

E. Commercial Paper: commercial paper with a term of 270 days or less of a corporation, finance company, or bank organized in the United States of America which is rated at the time of purchase in the highest rating category by S&P and Moody's, or, upon the discontinuance of either or both of such services, such other nationally recognized rating service as shall be determined by Borrower Order;

F. Certificates of Deposit, Etc.: negotiable or non-negotiable certificates of deposit, time deposits, overnight bank deposits, interests in money-market portfolios, or other similar banking obligations, issued or created by any commercial bank, savings and loan association, or mutual savings bank, which may include the Bond Trustee in its commercial banking capacity, if such obligations are secured as to principal, to the extent not insured by the Bank Insurance Fund or Savings Association Insurance Fund administered by the Federal Deposit Insurance Corporation, by a perfected first lien on obligations described in *Clause A* or *B* above which are held by the Bond Trustee (unless the Bond Trustee is the pledgor of such securities) or by a Federal Reserve Bank or Federal Reserve Depository or third-party commercial bank or trust company, as custodian, free and clear of any adverse claim, and the market value of which is at all times at least equal to the principal amount of such obligations;

G. Repurchase Agreements: repurchase agreements with a term of 30 days or less, if (i) such agreement is entered into with a primary government securities dealer reporting to the Federal Reserve Bank of New York or a bank or trust company and the senior unsecured debt obligations of such counterparty are rated, at the time of entering into such agreement, "A" or better by Moody's and S&P, or, upon the discontinuance of either or both of such services, at an equivalent level by such other nationally recognized rating services as shall be determined by Borrower Order, (ii) such agreement is secured by a perfected first lien on obligations described in *Clause A* or *B* above which are held by the Bond Trustee (unless the Bond Trustee is the pledgor of such securities) or by any Federal Reserve Bank or Federal Reserve Depository or third-party commercial bank, as custodian, free and clear of any adverse claim, and the market value of which is valued at least weekly and is maintained at a level at least equal to 104% of the amount payable under such agreement, and (iii) the Bond Trustee receives an Opinion of Counsel to the effect that such agreement is an authorized investment of the funds to be invested therein under Texas law;

H. Mutual Funds: shares of a "management company" that is both an "open-end company" and a "diversified company" (as such terms are defined in the Investment Company Act of 1940) and also a money market fund, including those of the Bond Trustee and its Affiliates and with respect to which the Bond Trustee or its Affiliates may receive compensation, if such shares are registered with the United States Securities and Exchange Commission under the Securities Act of 1933 and are rated, at the time of purchase, "AAAm-G," "AAA-m," or "AA-m" by S&P or "Aaa," "Aa1," or "Aa2" by Moody's, or, upon the discontinuance of either or both of such services, at an equivalent level by such other nationally recognized rating services as shall be determined by Borrower Order;

I. Federal Funds; Bankers Acceptances: federal funds or bankers acceptances with a remaining term at the time of purchase of one year or less, if issued or created by a bank the unsecured, uninsured, nonguaranteed obligations of which are rated, at the time of purchase, "Prime-1" or "A3" or better by Moody's and "A-1" or "A" or better by S&P or, upon the discontinuance of either or both such services, at an equivalent level by such other nationally recognized rating services as shall be determined by Borrower Order;

J. Investment Funds: shares, certificates or units in any short term investment fund (including mutual funds and money market funds), which fund, at the time of purchase, is rated in one of the two highest rating categories by a nationally recognized rating agency (without regard to any numerical or other modifier), including, any fund for which the Bond Trustee or its Affiliates is a manager, if such fund meets these requirements; and

K. Money Market Accounts: any money market account with a commercial bank having a combined capital, surplus and undivided profits of at least \$100,000,000 and subject to supervision or examination by federal or state authority.

"**Enabling Act**" means the Cultural Education Facilities Finance Corporation Act, Article 1528m, Vernon's Annotated Texas Civil Statutes, as amended, from time to time, or any successor provisions of Texas law.

“**Event of Default**” under the Bond Indenture has the meaning stated under the caption “**THE BOND INDENTURE—Events of Defaults and Remedies**” in this Appendix C and under the Master Indenture has the meaning stated under the caption “**THE MASTER INDENTURE—Defaults and Remedies**” in this Appendix C. An Event of Default “**exists**” if an Event of Default has occurred and is continuing.

“**Financial Hedge**” means an agreement, contract, transaction or other obligation entered into by a Person in order to hedge the interest payable on all or a portion of any Debt, that may include, without limitation, a rate swap transaction, rate option, forward rate transaction, basis swap transaction, credit derivative transaction, commodity swap transaction, commodity option, forward commodity transaction, equity or equity index swap or option, bond or bond price or bond index swap or option, forward bond or forward bond price or forward bond index transaction, cap transaction, floor transaction, collar transaction, currency swap transaction, currency option, cross-currency rate swap transaction, forward foreign exchange transaction, or spot contract, and which agreement, contract, transaction or other obligation does not constitute an obligation to repay money borrowed, credit extended or the equivalent thereof.

“**Financial Statements**” means, as applicable, the Combined Group Financial Statements or the System Financial Statements, and with respect to any other Person, for any period, the financial statements of such Person meeting the requirements described in the Master Indenture.

“**Fiscal Year**” means the fiscal year of each Member of the Combined Group or of the System, as applicable, ending on June 30 of each calendar year, or such other consecutive 12-month period selected by the Combined Group Representative as the fiscal year for each Member of the Combined Group or for the System and designated from time to time in writing by the Combined Group Representative to the Trustee, and subject to the designation of an Interim Period pursuant to the Master Indenture; *provided* that for purposes of making calculations or determinations set forth in the Master Indenture on a Fiscal Year basis, or for purposes of combinations or consolidations of accounting information, with respect to those Persons whose actual fiscal year is different from that designated above, the actual fiscal year of such Persons which ended within the Fiscal Year of the Members of the Combined Group or of the System, as applicable, shall be used.

“**Fourth Supplement**” means the Fourth Supplement to Master Indenture of Trust and Security Agreement, dated as of April 19, 2016, among BSW Holdings, as Combined Group Representative on behalf of the Obligated Affiliates, BSW Health, Garland, College Station and the Trustee.

“**General Intangibles**” means all general intangibles (as such term is defined in Article 9 of the Uniform Commercial Code) of the Obligated Affiliates, including without limitation trademarks, copyrights, patents, contracts, licenses, franchises, trade names, computer programs and other computer software, inventions, designs, trade secrets, goodwill, proprietary rights, customer lists, supplier contacts, sale orders, correspondence, and advertising materials.

“**Grapevine**” means Baylor Regional Medical Center at Grapevine, a Texas nonprofit corporation.

“**Hillcrest Medical Center**” means Hillcrest Baptist Medical Center, a Texas nonprofit corporation.

“**Holder**” when used with respect to Master Debt means the Person in whose name such Master Debt is registered in the Master Debt Register, subject to certain provision of the Master Indenture. “**Holder**” when used with respect to any Bond, means the Person in whose name such bond is registered in the Bond Register established pursuant to the Bond Indenture.

“**Independent**” when used with respect to any specified Person means such a Person who (1) is in fact independent, (2) does not have any direct financial interest or any material indirect financial interest in the Issuer, the Borrower, any other Obligated Affiliate, or any other obligor upon the Bonds or in any Affiliate of the Issuer, the Borrower, any other Obligated Affiliate, or such other obligor, and (3) is not connected with the Issuer, the Borrower, any other Obligated Affiliate, or such other obligor as an officer, employee, promoter, underwriter, trustee, partner, director, or person performing similar functions. Whenever it is provided that any Independent Person’s opinion or certificate shall be furnished to the Bond Trustee, such Person shall be appointed by an Issuer

Order or the Borrower Order, as the case may be, and such opinion or certificate shall state that the signer has read this definition and that the signer is Independent.

“Interim Period” means the period of greater than or less than 12 months preceding a new Fiscal Year designated by the Combined Group Representative for the Members of the Combined Group or for the System.

“Issue Date” means the date on which the Bonds are first authenticated and delivered to the initial purchasers against payment therefor.

“Issuer” means Tarrant County Cultural Education Facilities Finance Corporation, which term includes any successor corporation under the Bond Indenture.

“Management Consultant” means an Independent firm that is a professional consultant selected by the Combined Group Representative and having the skill and experience necessary to render the report required by the provision in the Master Indenture in which such requirement appears.

“Master Debt” means the Series 2016A Note and other Debt from time to time issued, incurred, assumed, or guaranteed under the Master Indenture pursuant to the terms of the Master Indenture, whether or not the same is or evidences Debt, until such obligations have been discharged from the lien of the Master Indenture.

“Master Debt Register” means the register caused to be maintained by the Combined Group Representative to provide for the registration and transfer of Master Debt.

“Master Indenture” means that certain Master Indenture of Trust and Security Agreement, dated as of February 1, 2014, among the Obligated Affiliates named therein and the Master Trustee, as amended by a First Supplement to Master Indenture of Trust and Security Agreement, dated as of April 1, 2014, a Second Supplement to Master Indenture of Trust and Security Agreement, dated as of May 1, 2015, a Third Supplement to Master Indenture of Trust and Security Agreement, dated as of April 1, 2016, and the Fourth Supplement, and as it may from time to time be further supplemented, modified, or amended by one or more indentures or other instruments supplemental thereto entered into pursuant to the applicable provisions thereof.

“Master Trustee” means The Bank of New York Mellon Trust Company, National Association, as trustee for the holders of Master Debt (as defined in the Master Indenture) under the Master Indenture, until a successor trustee shall have become such pursuant to the applicable provisions of the Master Indenture, and thereafter, **“Master Trustee”** shall mean such successor trustee.

“Maturity” when used with respect to any Bond means the date on which the principal of such Bond becomes due and payable, whether at the Stated Maturity or by declaration of acceleration or call for redemption or otherwise.

“Maximum Annual Debt Service Requirements” means the largest total Annual Debt Service Requirements for the current Fiscal Year or any succeeding Fiscal Year.

“McKinney” means Baylor Medical Centers at Garland and McKinney, a Texas nonprofit corporation.

“Medicaid” means the government-sponsored entitlement program, which provides federal grants to states for medical assistance based on specific eligibility criteria, as established pursuant to the Social Security Act (42 U.S.C. 1396 *et seq.* and related statutes) and any successor, replacement, or related program.

“Medicare” means the government-sponsored insurance program, which provides for a health insurance system for eligible elderly and disabled individuals, as established pursuant to the Social Security Act (42 U.S.C. 1395 *et seq.* and related statutes) and any successor, replacement, or related program.

“Medicare/Medicaid Receivables” means all accounts and other rights to payment now or at any time hereafter owing, and all reimbursements now or hereafter due, whether directly or indirectly through an

intermediary, from the United States Health Care Financing Administration, the United States Department of Health and Human Services, any other governmental authority, or any other Person in connection with Medicare and Medicaid, the Civilian Health and Medical Program of the Uniform Services, and the Civilian Health and Medical Program of the Veterans' Administration.

“**Member**” when used with respect to the Combined Group, means an Obligated Affiliate or Restricted Affiliate.

“**Memorial Hospital**” means Scott & White Memorial Hospital, a Texas nonprofit corporation.

“**Moody's**” means Moody's Investors Service, Inc. and any successor to its credit rating service.

“**Net Revenues**” of any Person for any period means the amount of excess (deficit) of revenue over expense, or net income, of such Person for such period, *plus*, if not otherwise included in such revenue or income, the realized income, if any, of such Person for such period from the investment of any funds (*but only* to the extent that such income may be applied to one or more items included in the Annual Debt Service Requirements of such Person for such period, assuming any necessary action by such Person), as determined in accordance with and pursuant to the Master Indenture, *plus* amounts deducted for such period for or to make provision for:

(1) interest and other debt service charges on Debt, or the deemed interest or other debt service charges on such Debt if adjusted in accordance with *Clause (D)* of the definition of “*Annual Debt Service Requirements*,”

(2) amortization of Debt discount, issuance expense, and goodwill, and

(3) property retirement, depreciation (as the same may be adjusted as provided above), depletion, obsolescence, and impairment,

all determined after eliminating intercompany items in accordance with generally accepted accounting principles, *but* without taking into account:

(a) any gain or loss resulting from either the extinguishment or refinancing of Debt or Financial Hedges or the sale, exchange, or other disposition of capital assets not made in the ordinary course of business,

(b) net proceeds of insurance (other than business interruption insurance) and condemnation awards,

(c) unusual, infrequent, or extraordinary non-cash items, unrealized gains and losses and other mark-to-market adjustments on investments and Financial Hedges that do not result in the receipt or require an expenditure of cash,

(d) any “other-than-temporary” impairment loss;

(e) any amounts received or paid as net scheduled payments pursuant to a Financial Hedge, provided the hedge rate thereunder is used in calculating Annual Debt Service Requirements,

(f) any amounts received or paid as termination payments pursuant to a Financial Hedge,

(g) gifts, grants, bequests, donations, or contributions, to the extent specifically restricted by the donor to a particular purpose inconsistent with their use for the payment of principal of (and premium, if any) and interest and other debt service charges on Debt or of operating expenses,

(h) income from funds or securities irrevocably deposited or set aside in trust or escrowed for the payment of principal of (and premium, if any) or interest or other debt service charges on Debt of such Person, *if* such debt service charges are excluded from the Annual Debt Service Requirements to which such Net Revenues are

to be compared pursuant to *Clause (F)* or *(G)* of the definition of “*Annual Debt Service Requirements*” or pursuant to *Clause (3)* of the definition of “*Outstanding*,” or

(i) any items in a Person’s financial statements for a particular Fiscal Year that are the result of or required by any correction, adjustment or restatement of, or the retrospective application of accounting standards to, such Person’s Financial Statements for any other Fiscal Year,

provided that, for such purposes, in determining gain or loss from the sale or other disposition of any asset for which an “other-than-temporary” impairment loss has theretofore been recognized in accordance with Financial Accounting Statement No. 115, any such gain shall be reduced (and any such loss shall be increased) by the amount of such loss previously recognized; and *provided further* that, if any percentage of debt service on Debt of any other primary obligor is included in the Annual Debt Service Requirements of such Person for such period or any future fiscal year pursuant to *Clause (E)* of the definition of “*Annual Debt Service Requirements*,” then the Net Revenues of such primary obligor for such period shall be included in the Net Revenues of such Person for such period up to the lesser of (i) the same percentage of such primary obligor’s Net Revenue for such period or (ii) the amount of debt service of such primary obligor so included in such period or future fiscal year, as applicable; and *provided further* that, at the option of the Combined Group Representative, net realized gains and losses from the sale of investments may be included in the computation of Net Revenues on the basis of the average annual amount of those gains and losses for the three Fiscal Years preceding the computation date, rather than including the actual amount of net realized gains and losses from the sale of investments for the period for which a computation is being made.

“**New Group**” means those Obligated Affiliates and any other Persons who agree (A) to become jointly and severally obligated under the Replacement Master Indenture for any obligations thereunder, and (B) to otherwise comply with the provisions of the Replacement Master Indenture.

“**Obligated Affiliate**” means each Person named as Obligated Affiliate under the caption “**THE MASTER INDENTURE – Current Obligated Affiliates**” in this Appendix C until the release of such Person pursuant to the Master Indenture, and any Person who has become an Obligated Affiliate pursuant to the Master Indenture and has not been released pursuant thereto.

“**Officer’s Certificate**” of the Issuer means a certificate signed by any officer of the Issuer and of the Borrower means a certificate signed by any officer of the Borrower and, in either case, delivered to the Bond Trustee, and, in the case of a certificate of the Issuer, delivered to the Borrower.

“**Opinion of Counsel**” means a written opinion of counsel who may (except as otherwise expressly provided in the Bond Indenture) be counsel for any one or more of the Issuer, the Borrower, or any other Obligated Affiliate and shall be acceptable to the Bond Trustee and, when given with respect to the status of interest on any Bond under federal income tax law, shall mean counsel of nationally recognized standing in the field of municipal bond law.

“**Outstanding**” when used with respect to Bonds means, as of the date of determination, all Bonds theretofore authenticated and delivered under the Bond Indenture, except, without duplication:

(A) **Cancelled Bonds:** Bonds theretofore canceled by the Bond Trustee or delivered to the Bond Trustee for cancellation;

(B) **Non-Presented Bonds:** Bonds for the payment or redemption of which money in the necessary amount has been theretofore deposited with the Bond Trustee or any Paying Agent at or after the Maturity thereof in trust for the Holders of such Bonds;

(C) **Transferred, Exchanged, and Replaced Bonds:** Bonds in exchange for or in lieu of which other Bonds have been authenticated and delivered under the Bond Indenture;

(D) **Paid Lost Bonds:** Bonds alleged to have been destroyed, lost, or stolen which have been paid as provided in the Bond Indenture; and

(E) **Defeased Bonds:** Bonds for the payment of the principal of (and premium, if any) and interest on which money or obligations that are considered Eligible Investments described in *Clause (A)* under such definition or both are held by the Bond Trustee or an escrow agent with the effect specified under the caption “**THE BOND INDENTURE–Defeasance**” in this Appendix C.

provided, however, that in determining whether the Holders of the requisite principal amount of Bonds Outstanding have given any request, demand, authorization, direction, notice, consent, or waiver, Bonds owned by the Issuer, the Borrower, any other Obligated Affiliate, or any other obligor upon the Bonds or any Affiliate of the Issuer, the Borrower, any other Obligated Affiliate, or such other obligor shall be disregarded and deemed not to be Outstanding, except that, in determining whether the Bond Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent, or waiver, only Bonds which the Bond Trustee knows to be so owned shall be so disregarded. Bonds so owned which have been pledged in good faith may be regarded as Outstanding for such purposes if the pledgee establishes to the satisfaction of the Bond Trustee the pledgee’s right so to act with respect to such Bonds and that the pledgee is not the Issuer, the Borrower, any other Obligated Affiliate, or any other obligor upon the Bonds or any Affiliate of the Issuer, the Borrower, any other Obligated Affiliate, or such other obligor.

When applying such definition under the Master Indenture, and when used with respect to Master Debt or Debt, “**Outstanding**” means, as of the date of determination, all Master Debt or Debt except such Master Debt or Debt or any part thereof:

- (1) **Retired Debt:** which has been paid or otherwise retired, or
- (2) **Gross Cash Defeasance:** for the payment or redemption of which sufficient money has been irrevocably deposited with the payee thereof or a third party for the payment thereof (*provided* that, if such Master Debt or Debt is to be redeemed, notice thereof shall have been duly given, irrevocably provided for to the satisfaction of the Master Trustee, or waived), or
- (3) **Net Cash Defeasance:** for which either (a) due to the irrevocable deposit of money, securities, or other thing of value with a trustee, paying agent, or escrow agent with respect thereto, none of the Combined Group Representative, any Obligated Affiliate, or any Restricted Affiliate is then obligated with respect thereto except from and to the extent of the money, securities, or other thing so deposited and proceeds thereof or (b) there shall have been irrevocably deposited with a trustee, paying agent, or escrow agent the necessary funds (or evidences of such Master Debt or Debt or securities that will provide sufficient funds, if permitted by the instrument creating such Debt) for the payment, redemption, or satisfaction thereof, or
- (4) **Release:** when used with respect to Master Debt, which is no longer entitled to the benefits of the Master Indenture due to its release as described under the caption “**THE MASTER INDENTURE – Concerning the Obligated Affiliates – Withdrawal of Obligated Affiliates**” in this Appendix C;

provided, however, that in determining whether the Holders of the requisite principal amount of Master Debt Outstanding have given any request, demand, order, authorization, direction, notice, consent, waiver or other Act:

- (i) Master Debt owned by the Combined Group Representative, any Obligated Affiliate, any Restricted Affiliate, or any other obligor upon Master Debt or any Affiliate of the Combined Group Representative, any Obligated Affiliate, any Restricted Affiliate, or such other obligor shall be disregarded and deemed not to be Outstanding, *except* that (A) in determining whether the Master Trustee shall be protected in relying upon any such request, demand, order, authorization, direction, notice, consent, waiver or other Act, only Master Debt which the Master Trustee knows to be so owned shall be so disregarded, and (B) Master Debt so owned which has been pledged in good faith may be regarded as Outstanding for such purposes if the pledgee establishes to the satisfaction of the Master Trustee the pledgee’s right so to act with respect to such Master Debt and that the pledgee is not the Combined Group Representative, an Obligated Affiliate, a Restricted Affiliate, or any other obligor upon Master Debt or any Affiliate of the Combined Group Representative, an Obligated Affiliate, a Restricted Affiliate, or such other obligor; and

(ii) “*principal*” means (A) with respect to any Master Debt that secures or constitutes a Financial Hedge, the amount, if any, that would be payable by an Obligated Affiliate if the transaction in respect of which such obligations are payable were terminated as of a recent date (within 30 days of the date of determination) specified by the Master Trustee, and (B) with respect to any other Master Debt, means the unpaid principal sum of such Master Debt, *but excludes* (1) the unpaid principal sum due and owing pursuant to Master Debt evidencing payment obligations under any facility providing liquidity, including without limitation any standby bond purchase agreement or similar facility or liquidity drawing under a letter of credit, to the extent evidenced or secured by other Master Debt or obligations secured thereby and (2) any principal amount that is available but not drawn down at the time of determination under a line of credit, letter of credit, revolving loan or similar facility secured by Master Debt.

“*Paying Agent*” means any Person authorized by the Issuer with the approval of the Borrower to pay the principal of (and premium, if any) or interest on any Bonds on behalf of the Issuer.

“*Permitted Encumbrances*” means:

(1) ***Deposits***: liens arising by reason of good faith deposits by or with any Member of the Combined Group in connection with tenders, leases of real estate, bids, or contracts (other than contracts for the payment of money), deposits by any such Person to secure public or statutory obligations or to secure, or in lieu of, surety or appeal bonds, and deposits as security for the payment of taxes or assessments or other similar charges;

(2) ***Governmental and Insurance Deposits***: any lien arising by reason of deposits with, or the giving of any form of security to, any governmental agency or any body created or approved by law or governmental regulation for any purpose at any time as required by law or governmental regulation as a condition to the transaction of any business or the exercise of any privilege or license in the ordinary course of business, or to enable any Member of the Combined Group to maintain self-insurance or to participate in any funds established to cover any insurance risks or in connection with worker’s compensation, unemployment insurance, old age pensions, or other social security, or to share in the privileges or benefits required for institutions participating in such arrangements, including without limitation any funds or assets required by law or governmental regulation to be kept free of encumbrance as a condition to the transaction of any business or the exercise of any privilege or license in the ordinary course of business, which will for all purposes of the Master Indenture be deemed a Permitted Encumbrance subject to a lien in favor of such governmental agency superior to any lien of the Master Trustee under the Master Indenture for so long as such transaction remains in effect;

(3) ***Judgment Liens***: liens created by or existing from any litigation or legal proceeding, or any judgment lien against any Person, so long as the finality of such litigation, legal proceeding or judgment is being contested in good faith and execution thereon is stayed;

(4) ***Governmental Restrictions***: rights reserved to or vested in any municipality or public authority by the terms of any right, power, franchise, grant, license, permit, or provision of law affecting any property (a) to terminate such right, power, franchise, grant, license, or permit, provided that the exercise of such right would not, in the judgment of the Combined Group Representative, materially impair the use of such property for its intended purpose, or materially and adversely affect the value thereof, if such property is material to the operation of the businesses of the Combined Group taken as a whole, or (b) to purchase, condemn, appropriate, recapture, or designate a purchaser of such property, or (c) to control, regulate, or zone such property or to use such property in any manner, which rights do not, in the judgment of the Combined Group Representative, materially impair the use of such property for its intended purposes or materially and adversely affect the value thereof;

(5) ***Governmental Programs***: statutory rights or liens of the United States of America or any state or the District of Columbia, or any agency or political subdivision thereof, by reason of funds being made available to any Member of the Combined Group under federal or state statutes, regulations or programs;

(6) **Taxes:** liens for taxes or assessments or other governmental charges or levies to the extent not required to be paid pursuant to the Master Indenture;

(7) **Worker's Compensation:** pledges or deposits to secure obligations under worker's compensation laws or similar legislation, including liens of judgments thereunder which are not currently dischargeable;

(8) **For Work and Supplies:** materialmen's, mechanics', carriers', workmen's, repairmen's, or other like liens arising in the ordinary course of business, or deposits to obtain the release of such liens;

(9) **Leases:** leases made, or existing on property acquired, in the ordinary course of business;

(10) **Landlords' Liens:** statutory landlords' liens under leases to which any Member of the Combined Group is a party or contractual landlords' liens on property located on the leased premises;

(11) **Service and Other Deposits:** liens on money deposited by or for the account of patients, customers or residents of any Person as security for or as prepayment of the cost of any service, item or residency arrangement provided by such Person;

(12) **Patient Financing:** liens, encumbrances, pledges or other security interests created or assumed by any Member of the Combined Group in order to provide or secure financing or credit arrangements for the payment of the cost of any service, item or residency arrangement provided by such Member of the Combined Group to any patient, customer or resident;

(13) **Restrictive Gifts:** liens or encumbrances on property (or on the income therefrom) received by any Member of the Combined Group as a gift, grant, or bequest, if such lien or encumbrance constitutes or results from restrictions (other than the requirement that the grantee thereof make payment in respect of Debt incurred by the grantor with respect to such property) placed on such gift, grant, or bequest (or on the income therefrom) by the grantor thereof;

(14) **Third Party Payor Recoupment:** statutory or contractual liens on money and receivables securing rights of third party payors to recoupment of amounts paid to any Member of the Combined Group;

(15) **Withheld Amounts:** liens on proceeds of Debt (or on income from the investment of such proceeds) that secure payment of such Debt or other Debt on parity with such Debt;

(16) **Certain Easements, Etc.:** easements, leases, reservations, or other rights of others in property for streets, roads, bridges, pipes, pipelines, railroads, electric transmission and distribution lines, telegraph and telephone lines, the removal of oil, gas, coal, or other minerals, and other similar purposes, flood rights, river control and development rights, sewage and drainage rights, restrictions against pollution, and zoning laws and defects and irregularities in the record evidence of title, *provided* that such easements, leases, reservations, rights, restrictions, laws, defects, and irregularities do not materially affect the marketability of title to such property, or the use of such property for the purposes for which it is held, *if* such property is material to the operation of the businesses of the Combined Group taken as a whole;

(17) **Liens on Servient Estates:** liens securing indebtedness not created, assumed, or guaranteed by any Member of the Combined Group nor on account of which any such Person customarily pays interest, existing at the date of the Master Indenture, or, as to property hereafter acquired, at the time of acquisition by any such Person, upon lands over which easements or rights-of-way are acquired by any such Person for any of the purposes specified in *Clause (16)* of this definition, which liens do not materially impair the use of such easements or rights-of-way for the purposes for which they are held by such Person;

(18) **Salary and Wages:** liens or privileges of any employees of any Member of the Combined Group for salary or wages earned but not yet payable;

(19) **Minor Irregularities:** any irregularities in or deficiencies of title to any real estate used or to be used primarily for right-of-way purposes, provided that any Member of the Combined Group shall have obtained from the apparent owner of the lands or estates therein covered by any such right-of-way a sufficient right, by the terms of the instrument granting such right-of-way, to the use thereof for the construction, operation, or maintenance of the lines, appurtenances, or improvements for which the same are used or are to be used;

(20) **Mineral Interests:** any charge or encumbrance arising from a conveyance by any Member of the Combined Group of a production payment with respect to mineral deposits owned or leased by such Person; farm-out or carried working interest agreements for development by any Member of the Combined Group or others of non-producing leases or non-producing portions of oil or gas producing properties; and participations in joint-operating agreements, unitization agreements and operations covering, in each case, oil and gas producing properties;

(21) **Priority Claims of Debtors:** claims of creditors entitled to priority under the so-called “six months rule” as applied by courts of equity in proceedings for the administration of insolvent corporations;

(22) **Trustee Held Funds:** liens on money or obligations deposited with a trustee or escrow agent to cause Debt to be no longer Outstanding or to fund a depreciation reserve fund or other reserve fund with respect to Debt in accordance with the instrument under which such Debt may be secured;

(23) **Existing Liens:** any mortgage, lien, charge, encumbrance, pledge or other security interest existing with respect to property at the time of its acquisition through purchase, merger, consolidation, or otherwise; *provided* that (i) such mortgage, lien, charge, encumbrance, pledge or other security interest was not created in contemplation of such acquisition, and (ii) the aggregate principal amounts secured by such mortgage, lien, charge, pledge or other encumbrance shall not exceed at the time of acquisition of such property the lesser of the cost or fair market value of such property as determined in good faith by the Person acquiring the property;

(24) **De Minimis and Combined Group Entry Liens:** any mortgage, lien or other encumbrance (a) securing a Debt of less than \$500,000 or (b) disclosed in a loan agreement or any supplement to the Master Indenture pursuant to which a Person becomes a Member of the Combined Group;

(25) **Credit or Liquidity Enhancement:** any lien or other encumbrance on debt instruments owned by or on behalf of a Person that have been purchased under a credit or liquidity facility issued to secure or support other Debt; and

(26) **Ordinary Course Encumbrances:** any other lien or encumbrance created or incurred in the ordinary course of business that does not secure, directly or indirectly, the repayment of Debt and which does not, individually or in the aggregate and in the judgment of the Combined Group Representative, materially impair the value or the utility of the property subject to such lien or encumbrance.

“**Person**” means any individual, corporation, partnership, joint venture, association, joint-stock or limited liability company, trust, unincorporated organization, or government or any agency or political subdivision thereof.

“**Plano**” means Baylor Regional Medical Center at Plano, a Texas nonprofit corporation.

“**Projects**” means the projects described in the Loan Agreement to be financed and refinanced with proceeds of the Bonds.

“**Rating Agency**” means any nationally recognized rating agency that maintains a rating on the Bonds at the request of the Borrower. Initially, the Rating Agencies are Moody’s Investors Service, Inc. and Standard & Poor’s Rating Services, a Standard & Poor’s Financial Services LLC business.

“**Receipts**” of any Person for any period means all cash, coin, currency, money, checks, drafts, or promissory notes received during such period by or on behalf of or for the account of such Person from any source and for any purpose, including without limitation any such items received from or consisting of:

- (1) adjustments under policies of insurance,
- (2) awards for or compensation for damages,
- (3) payments for the sale, lease, or disposition of assets,
- (4) gifts, grants, bequests, donations, and contributions,
- (5) income from investments or the payment of indebtedness,
- (6) reimbursement or payments from third party payors, including Medicare and Medicaid, *but only* to the extent not prohibited by applicable law, and
- (7) rent,

but excluding any such items derived from or consisting of:

- (a) gifts, grants, bequests, donations, and contributions restricted to a purpose other than the payment of Master Debt or of operating expenses, and
- (b) amounts received by such Person as agent for or on behalf of any other Person.

“**Rebate Fund**” means the fund of the Issuer so defined in the Bond Indenture and described in this Appendix C under the caption “**THE BOND INDENTURE–Funds Under the Bond Indenture–Rebate Fund.**”

“**Related Rights**” means all chattel paper (as such term is defined in Article 9 of the Uniform Commercial Code), documents (as such term is defined in Article 9 of the Uniform Commercial Code), and/or instruments (as such term is defined in Article 9 of the Uniform Commercial Code) relating to Accounts, General Intangibles, Receipts, Contract Rights, and Bank Accounts and all rights now or hereafter existing in and to all security agreements, leases, and other contracts securing or otherwise relating to Accounts, General Intangibles, Receipts, Contract Rights, or Bank Accounts or any such chattel paper, documents, and/or instruments.

“**Replacement Master Indenture**” means a master trust indenture entered into by the New Group and a master trustee that, *inter alia*, provides either (i) that all Outstanding Master Debt under the Master Indenture shall be deemed to be a note or obligation issued under and entitled to the security and benefits of such Replacement Master Indenture without the necessity of any amendment, exchange or replacement of such Master Debt, or (ii) for the exchange or replacement of all Outstanding Master Debt under the Master Indenture with notes or obligations issued under and entitled to the benefits of such Replacement Master Indenture.

“**Restricted Affiliate**” means, at any date, any Affiliate (other than an Obligated Affiliate) of any Obligated Affiliate which meets the following requirements:

- (1) **No Other Ownership:** either (a) such Affiliate is a non-stock, membership entity of which one or more Obligated Affiliates, or one or more Restricted Affiliates, are the sole members, or a non-stock, non-membership entity, or a trust the sole beneficiaries of which are one or more Obligated Affiliates, or one or more Restricted Affiliates, or (b) all of the outstanding shares of stock of such Affiliate (other than directors’ qualifying shares or shares required to be owned by directors under any applicable law) are owned by the Combined Group;
- (2) **Power to Control:** if such Affiliate is a non-stock entity or a trust, one or more Obligated Affiliates has the right to elect or appoint and to remove, with or without cause, all directors or trustees

thereof (or all directors or trustees of one or more other Restricted Affiliates which have such right), and a permitted power of such Affiliate is to pay (or to transfer funds to an Obligated Affiliate to pay) Master Debt; and

(3) **Current Qualification:** such Affiliate is not an Obligated Affiliate, has become a Restricted Affiliate pursuant to the Master Indenture, and has not thereafter been released from its status as a Restricted Affiliate pursuant to the Master Indenture.

“**Round Rock**” means Scott & White Hospital – Round Rock, a Texas nonprofit corporation.

“**S&P**” means Standard & Poor’s Ratings Services, a Standard & Poor’s Financial Services LLC business, and any successor to its credit rating service.

“**S&W**” means Scott & White Healthcare, a Texas nonprofit corporation.

“**S&W Clinic**” means Scott & White Clinic, a Texas nonprofit corporation.

“**Scott & White Series 2010 Bonds**” means the Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds (Scott & White Healthcare Project) Series 2010, dated June 24, 2010, and issued pursuant to the Scott & White 2010 Indenture.

“**Scott & White Series 2010 Indenture**” means the Trust Indenture, dated as of June 1, 2008, as supplemented by the Third Supplemental Trust Indenture, dated as of June 1, 2010, each between the Tarrant County Cultural Education Facilities Finance Corporation and The Bank of New York Mellon Trust Company, National Association, as successor trustee.

“**Securities Depository**” means The Depository Trust Company or any successor Person appointed by Borrower Order to act as Holder of the Bonds, directly or through a nominee, and to maintain a system for recording and transferring beneficial interests in such Bonds and distributing payments thereon and notices in respect thereof.

“**Senior Master Debt**” means the indebtedness and other obligations evidenced by the promissory notes and other instruments made by BHCS, S&W and Memorial Hospital that are specifically listed in the Master Indenture, subject to *Clause (b)* of the last paragraph under the caption “**THE MASTER INDENTURE – Issuance of Master Debt Under the Master Indenture**” in this Appendix C, and any other Master Debt issued under the Master Indenture on a *pari passu* basis with such promissory notes, subject to *Clause (b)* of the last paragraph under the caption “**THE MASTER INDENTURE – Issuance of Master Debt Under the Master Indenture**” in this Appendix C.

“**Series 2016A Note**” means the promissory note made by BSW Holdings pursuant to the Loan Agreement to evidence the obligation of BSW Holdings to make payments under the Loan Agreement.

“**Stated Maturity**” when used with respect to any Bond or any installment of interest thereon means the date specified in such Bond as the fixed date on which the principal of such Bond or such installment of interest is due and payable.

“**Subordinate Master Debt**” means any Master Debt issued under the Master Indenture on a basis immediately subordinate to the Senior Master Debt, including any payment owed to a counterparty to a Financial Hedge obligation that is required to be Subordinate Master Debt as described in *Clause (b)* of the last paragraph under the caption “**THE MASTER INDENTURE–Issuance of Master Debt under the Master Indenture.**”

“**System**” means, for purposes of this Appendix C, the Person that all of the financial results of the Combined Group consolidate into or, if no such single Person exists, the group of Persons comprised of all Members of the Combined Group and all of their Affiliates.

“**System Financial Statements**” means the consolidated financial statements prepared in accordance with generally accepted accounting principles, including financial information of the Members of the Combined Group and of any Affiliate the financial information of which is required by generally accepted accounting principles to be consolidated with the financial information of the Members of the Combined Group.

“**Transaction Test**” means the Trustee shall have received an Officer’s Certificate of the Combined Group Representative:

(a) stating that no Default or Event of Default under the Master Indenture then exists or would result from the proposed transaction; and

(b) (i) demonstrating that the Consolidated Net Revenues of the Combined Group following the proposed transaction would not be less than 150% of the Maximum Annual Debt Service Requirements of the Obligated Affiliates; or

(ii) demonstrating that the unrestricted net assets of the Obligated Affiliates immediately after the proposed transaction will be at least equal to 70% of the unrestricted net assets of the Obligated Affiliates immediately prior to the proposed transaction, based on Financial Statements for the most recent Fiscal Year.

“**Trust Estate**” means, for the Bond Indenture, the property described as such under the granting clauses of the Bond Indenture, and, for the Master Indenture, the property described as such under the granting clauses of the Master Indenture.

“**Value**” of any property of any Person means, at the option of such Person, either the book value of such property or the Current Value of such property.

“**Waxahachie**” means Baylor Medical Center at Waxahachie, a Texas nonprofit corporation.

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THE BOND INDENTURE

The following is a summary of certain provisions of the Bond Indenture. This summary does not purport to be complete and is subject in all respects to the provisions of, and qualified in its entirety by reference to, the Bond Indenture. Additional information summarizing certain provisions of the Bond Indenture is contained under “**THE BONDS.**”

Pledge and Assignment

The Bond Indenture constitutes a collateral assignment by the Issuer to the Bond Trustee of all of the Issuer’s right, title and interest in and to the Loan Agreement and the Series 2016A Note (except for the Issuer’s rights to payment of certain expenses and indemnification) and to all money and investments in the funds and accounts held under the Bond Indenture in trust to secure payment of the Bonds. The Bond Indenture assigns to the Bond Trustee all voting rights with respect to the Series 2016A Note under the Master Indenture, which it must exercise at the direction of the Bondholders of a majority in principal amount of the Bonds.

Funds Under the Bond Indenture

The Bond Indenture establishes with the Bond Trustee a Bond Fund, a Proceeds Fund and a Rebate Fund.

Bond Fund. The Bond Trustee will deposit to the credit of the Bond Fund all loan payments made by BSW Holdings to the Bond Trustee for the account of the Issuer pursuant to the Series 2016A Note or the Loan Agreement. Amounts in the Bond Fund will be applied to pay principal of and premium, if any, and interest on the Bonds as they become due.

Proceeds Fund. The Bond Trustee will deposit to the credit of the Proceeds Fund immediately upon the receipt of proceeds from the sale of the Bonds. On the Issue Date, the Bond Trustee will transfer from the Proceeds Fund to The Bank of New York Mellon Trust Company, National Association, as Escrow Agent (the “**Escrow Agent**”) the amount specified in the Escrow Agreement, dated as of April 1, 2016, among such Escrow Agent, the Issuer and the Borrower (the “**Escrow Agreement**”), to be credited to the Escrow (as defined in the Escrow Agreement) held by such Escrow Agent thereunder, and thereafter withdraw from the Proceeds Fund the amount specified to pay, or to reimburse BSW Holdings, for Costs of the Project, including costs of issuance of the Bonds.

Rebate Fund. The Bond Trustee will deposit to the credit of the Rebate Fund arbitrage rebate payments from BSW Holdings. The Rebate Fund is established for the purpose of complying with Section 148 of the Code. The money deposited into the Rebate Fund will be applied to make arbitrage rebate payments to the United States, unless in the Opinion of Counsel failure to make such application will not adversely affect any exclusion from gross income of interest paid or to be paid on any Bond under the Code. See “**TAX EXEMPTION**” of the Official Statement.

Investment

All moneys in any fund under the Bond Indenture may, at the direction of BSW Holdings, be invested and reinvested in Eligible Investments, provided that the Rebate Fund will be invested and reinvested in Eligible Investments described in *Clause (A)* under such definition.

Events of Default and Remedies

Each of the following is an “**Event of Default**” under the Bond Indenture:

(A) Payment of principal of (or premium, if any on) any Bond is not made at its maturity or upon call for redemption or any interest on any Bond is not made when due and payable; or

(B) Failure by the Issuer to observe or perform any other covenant or warranty under the Bond Indenture, or failure of BSW Holdings to observe or perform any covenant or warranty under the

Loan Agreement, for a period of 30 days after written notice of such failure is given to the Issuer or BSW Holdings by the Bond Trustee or the Holders of at least 10% in principal amount of the Bonds, except that, if the default or breach can be corrected with due diligence, it will not be an Event of Default if corrective action is instituted within such 30-day period and diligently pursued until the default is corrected; or

(C) Certain events of voluntary or involuntary bankruptcy involving the Issuer; or

(D) Declaration of acceleration of the Series 2016A Note under the Master Indenture, except that if such declaration is rescinded and annulled, then the Event of Default under the Bond Indenture will also be deemed to have been cured or waived.

If an Event of Default occurs and is continuing, the Bond Trustee may, and at the request of the Holders of 25% or more in principal amount of the Bonds, must, declare the principal of and accrued interest on the Bonds to be due and payable immediately.

After the Bond Trustee has declared an acceleration of payment of the Bonds or an acceleration has otherwise occurred under the Bond Indenture, but before any sale of the Trust Estate has been made or any judgment or decree for money due on any Bond has been obtained, the holders of a majority in principal amount of the outstanding Bonds may rescind and annul such declaration if: (A) the Issuer or BSW Holdings has deposited with the Bond Trustee a sum sufficient to make payment of all arrears on the Bonds and (B) all Events of Default have been cured or waived.

The Holders of a majority in principal amount of the outstanding Bonds may direct the remedies to be pursued by the Bond Trustee upon an Event of Default; otherwise the Bond Trustee in its discretion may direct the sale of the Trust Estate or pursue other remedies as it will deem most effectual to protect and enforce any of the rights of the Bond Trustee and the Bondholders. Upon any sale of any of the Trust Estate, the principal of and accrued interest on the Bonds outstanding will become immediately due and payable.

Any money collected by the Bond Trustee pursuant to the terms of the Bond Indenture and due to an Event of Default will be applied in the following order: (A) to pay amounts due the Bond Trustee and certain agents under the Bond Indenture, (B) to pay the principal of (and premium, if any) and interest on Bonds Outstanding, equally and ratably, and (C) to pay the balance thereof to BSW Holdings or to whomsoever may be lawfully entitled to receive such balance.

No Bondholder will have any right to institute any judicial or other proceeding with respect to the Bond Indenture unless (A) such person has previously given written notice to the Bond Trustee of a continuing Event of Default, (B) the Holders of not less than 25% in principal amount of the Outstanding Bonds have requested the Bond Trustee to institute proceedings in its own name, (C) such person has offered reasonable indemnity satisfactory to the Bond Trustee, (D) for 60 days after receipt of such notice, request and offer of indemnity the Bond Trustee has failed to institute any proceedings, and (E) the Bond Trustee has not received inconsistent directions from the Holders of a majority of the principal amount of the Outstanding Bonds. No provision of the Bond Indenture, however, may impair the right of the Holder of any Bond to institute suit for the payment of such Bond unless such suit would impair the lien of the Bond Indenture.

The Holders of not less than a majority in principal amount of the Outstanding Bonds may waive any past default under the Bond Indenture except (A) a default in the payment of principal of, premium, if any, interest on any Bond, or (B) in respect of a covenant or provision which may not be modified or amended without the consent of the Holder of each Outstanding Bond affected.

Supplemental Indentures

The Issuer and the Bond Trustee may, without the consent of the Bondholders and with the consent of BSW Holdings, enter into one or more indentures supplemental to the Bond Indenture for any of the following purposes: (A) to correct, amplify, add to or better assure any lien of the Bond Indenture, (B) to add conditions, limitations and restrictions to the terms of the Bonds, (C) to evidence the succession of a new Issuer, (D) to add

restrictive covenants of the Issuer or surrender a right or power conveyed upon the Issuer, (E) to cure any ambiguity, defect or omission in the Bond Indenture, if such change would not adversely affect the interests of the Bondholders, (F) to change provisions regarding the Rebate Fund or certain tax covenants, if in the Opinion of Counsel such change would not adversely affect any exclusion of interest on any Bond from the gross income of the owner thereof for federal income tax purposes, or (G) to modify, eliminate, or add to the provisions of the Bond Indenture to such extent as is necessary to qualify the Bond Indenture under the Trust Indenture Act of 1939, as amended, or any successor law.

The Issuer and the Bond may, with the consent of BSW Holdings and the Holders of not less than a majority in principal amount of the Bonds affected by the supplemental Bond Indenture, enter into one or more Bond Indentures supplemental to the Bond Indenture, but any such supplemental indenture which causes the following must be consented to by the holder of each Outstanding Bond affected: (A) a change in the stated maturity or payment rights on any Bond, (B) a reduction in the percentage in principal amount of Outstanding Bonds, the consent of the Holders of which is required to waive certain Bond Indenture provisions, (C) modification of the provisions of the proviso to the definition of the term “*Outstanding*,” (D) modification of the provisions of the Bond Indenture concerning supplemental indentures with the consent of Bondholders or concerning waiver of past defaults, (E) creation of any lien ranking prior to or on parity with the lien of the Bond Indenture with respect to the Trust Estate or terminating the lien of the Bond Indenture, or (F) modification of the rights of Bondholders to mandatory sinking fund redemption.

Defeasance

Any Bond will be no longer Outstanding under the Bond Indenture when payment of the principal of, premium, if any, on and all interest to become due on such Bond to the date of payment has been provided for by deposit with the Bond Trustee or an escrow agent of money, or money and Eligible Investments described in *Clause A* under the definition of such term, the principal of and interest on which, when due, has been certified by an accountant to be sufficient to make such payment. No such deposit, however, may be made (A) if an Event of Default exists, unless made with respect to all Bonds Outstanding, and (B) unless the Bond Trustee has received an opinion of counsel to the effect that the deposit will not adversely affect any exclusion from gross income of interest on any Bond for federal income tax purposes.

The Bond Trustee

The Bond Indenture provides that, except during the continuance of an Event of Default, the Bond Trustee must perform only the duties that are specifically set forth in the Bond Indenture. During the continuation of an Event of Default, the Bond Trustee must exercise the rights and powers vested in it by the Bond Indenture and use the care and skill a prudent person would exercise in the conduct of his or her own affairs. The Bond Indenture does not relieve the Bond Trustee from any liability for its own negligence or willful misconduct. The Bond Trustee may rely on directions of Holders of the requisite amount of Outstanding Bonds, is not required to investigate representations made in certifications presented to it, and is not required to risk its own funds. The Bond Trustee is not deemed to have knowledge of any Default or Event of Default except payment defaults on the Bonds or defaults in making specified deposits or filing specifically required certificates or notices, unless it has written notice from a Bondholder, the Issuer or BSW Holdings. The Bond Trustee is not required to exercise any powers under the Bond Indenture unless it is indemnified for costs and liabilities and is not obligated to investigate compliance with any covenants in the Loan Agreement or the Bond Indenture.

The Bond Trustee is required to give notice to Bondholders of the occurrence of an Event of Default within 90 days after the Bond Trustee obtains actual knowledge; *however*, except in the case of a payment default on the Bonds, the Bond Trustee may withhold such notice if it deems the withholding to be in the interest of the Bondholders.

The Bond Trustee may become the owner or pledgee of Bonds and may otherwise deal with the Issuer or BSW Holdings with the same rights it would have if it were not Bond Trustee.

The Bond Trustee must at all times be a corporation organized under the laws of the United States or any state, with a combined capital and surplus of at least \$50,000,000. If the Bond Trustee ceases to be eligible, it must

resign immediately. The Bond Trustee may resign at any time by giving notice and may be removed at any time, if no default by BSW Holdings under the Loan Agreement exists, by BSW Holdings. No resignation or removal will become effective until the acceptance of an appointment of a successor Bond Trustee. If the Bond Trustee resigns, is removed or becomes incapable of acting, the Issuer and BSW Holdings (unless BSW Holdings is in default under the Loan Agreement), must promptly appoint a successor. If no successor is appointed, the Bond Trustee or any Bondholder who has been an owner for at least six months may petition any court of competent jurisdiction for the appointment of a successor Bond Trustee.

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THE LOAN AGREEMENT

The following is a summary of certain provisions of the Loan Agreement. This summary does not purport to be complete and is subject in all respects to the provisions of, and qualified in its entirety by reference to, the Loan Agreement.

Loan and Note

In the Loan Agreement, the Issuer agrees to issue the Bonds and to lend the proceeds thereof to BSW Holdings for the purposes described herein under “**PLAN OF FINANCING**” of the Official Statement. BSW Holdings agrees to repay the loan by making payments of principal, interest and prepayment premium, if any (evidenced by the Series 2016A Note), on the same dates and in the same amounts as principal of and interest and redemption premiums on the Bonds. The loan may not be prepaid unless an equal amount of Bonds are redeemed or defeased.

Indemnification

BSW Holdings agrees to indemnify the Issuer and each of its directors and officers from certain losses, claims, damages or liabilities arising out of the issuance of the Bonds or the performance of BSW Holdings’ obligations under the Loan Agreement, and to pay certain expenses to the Issuer while the Bonds remain outstanding. In addition, BSW Holdings agrees to indemnify the Bond Trustee and certain other agents from certain losses arising out of the performance of their duties under the Bond Indenture or the Loan Agreement.

Tax Covenants of BSW Holdings

BSW Holdings covenants not to take any action or omit to take any action which would adversely affect the excludability of interest on any Bond from the gross income of the owner thereof for federal income tax purposes, as well as to observe and perform certain specific covenants intended to maintain such excludability. See “**TAX EXEMPTION**” of the Official Statement.

Limitation on Interest

In no event may the aggregate interest on the loan from the Issuer and the Series 2016A Note, plus any other amounts paid in connection with the Loan Agreement which are deemed “interest” under applicable law in effect on the Issue Date, ever exceed the maximum amount of interest which could be lawfully charged on the loan and the Series 2016A Note under applicable law. If any amount of interest taken or received by the Issuer is in excess of the maximum amount of interest which could lawfully have been collected on the loan and the Series 2016A Note, then such excess must be refunded promptly to BSW Holdings.

Acceleration

Any obligation to repay the loan on an accelerated basis due to an acceleration of the due date of the Bonds pursuant to the provisions described under the caption “**THE BOND INDENTURE—Events of Defaults and Remedies**” in this Appendix C will be an obligation of BSW Holdings under the Loan Agreement, and not an obligation of the Obligated Affiliates or evidenced by the Series 2016A Note, unless the Series 2016A Note is declared immediately due and payable pursuant to the Master Indenture. See “**THE MASTER INDENTURE—Defaults and Remedies**” in this Appendix C.

Waivers

The Issuer and the Bond Trustee may waive any past default under the Loan Agreement and its consequences, with the consent of the Holders of the same percentage in principal amount of the Outstanding Bonds as the consent of the holders of which is required for the waiver of past defaults under the Bond Indenture (as described under “**THE BOND INDENTURE—Events of Defaults and Remedies**” in this Appendix C).

BSW Holdings may, with the written approval of the Issuer and the Bond Trustee, omit in any particular instance to comply with any covenant or condition set forth in the Loan Agreement (except covenants to make loan payments, to comply with certain restrictions on use of the projects financed and refinanced by the Bonds, to provide for certain deficiencies under the Bond Fund, to pay certain fees, expenses, and charges under the Bond Indenture, to waive certain rights, or relating to the tax-exempt status of the Bonds under federal income tax law), if before or after the time for such compliance the Holders of at least a majority in principal amount of Bonds then Outstanding which are affected by such waiver waive such compliance.

Amendment

The Loan Agreement may be amended with the written consent of the Bond Trustee, but without consent of the Holders, to add projects to those described in the Loan Agreement, to evidence assignment and assumption of the Loan Agreement, to add restrictive covenants or to make other changes that do not adversely affect the interests of the Holders. The Loan Agreement may be amended in any other respect with the approval of the Holders of the same percentage in principal amount of the Bonds affected by a supplemental indenture as is required for a corresponding supplement to the Bond Indenture. See “**THE BOND INDENTURE–Supplemental Indentures**” and “**–Events of Default and Remedies**” in this Appendix C.

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THE MASTER INDENTURE

The following is a summary of certain provisions of the Master Indenture. Such discussion does not purport to be complete and is qualified in its entirety by reference to the Master Indenture itself.

Trust Estate

In order to secure the payment of the principal of (and premium, if any) and interest on the Outstanding Master Debt and the performance of the covenants contained in the Master Indenture and to declare the terms and conditions on which the Outstanding Master Debt are secured, the Obligated Affiliates have pledged and assigned to the Master Trustee, and granted a security interest in (i) all Receipts of the Obligated Affiliates, subject to certain provisions of the Master Indenture; (ii) all right, title and interest of the Obligated Affiliates in and to all money and investments, if any, held for the credit of any fund or account established by or under the Master Indenture; (iii) any and all property that may, from time to time be subjected to the lien and security interest of the Master Indenture by the Obligated Affiliates or by anyone on its behalf, subject to any reservations, limitations or conditions, and (iv) all Accounts, Bank Accounts, General Intangibles, Contract Rights, and Related Rights of the Obligated Affiliates, whether now owned or hereafter acquired or arising and wherever located, and all proceeds (including Cash Proceeds and cash equivalents), products, accessions, and replacements of the property described.

The Master Indenture and the rights, titles, liens, security interests, and assignments granted in the Master Indenture will cease, determine, and be void and will be released when the Obligated Affiliates or their successors or assigns pay, or cause to be paid, the Outstanding Master Debt, or there is deposited with the Master Trustee such amounts such that none of the Master Debt remains Outstanding under the Master Indenture, and the Master Trustee is paid all sums of money due or to become due to it under the Master Indenture.

The Trust Estate includes the property described in *Clauses (i) and (iv)* above until such time that the Scott & White Series 2010 Bonds are no longer Outstanding under and as defined in the Scott & White Series 2010 Indenture. After such time, the Trust Estate under the Master Indenture shall be comprised solely of the property set forth in *Clauses (ii) and (iii)* above, and the rights, titles, liens, security interests, and assignments described in *Clauses (i) and (iv)* above will cease, determine, and be void and will be released by the Master Trustee.

The Trust Estate is subject to any and all mortgages, liens, charges, encumbrances, pledges, and security interests granted, created, assumed, incurred, or existing in accordance with the provisions of the Master Indenture described under the caption “**THE MASTER INDENTURE – Limitations on Liens**” in this Appendix C (*excluding Clauses (4), (5) and (12)* thereof) as to the property covered thereby and all rent, insurance adjustments, condemnation awards, and sale and other proceeds derived from such property and all rights to payment of the same.

Current Obligated Affiliates

The current Obligated Affiliates under the Master Indenture are BSW Holdings, BHCS, BUMC, All Saints, Grapevine, Plano, Waxahachie, S&W, Memorial Hospital, S&W Clinic, Round Rock, Continuing Care Hospital, and Hillcrest Medical Center. It is anticipated that effective on the closing date of the Bonds, McKinney, College Station and BSW Health will be added as Obligated Affiliates under the Master Indenture. There are currently no Restricted Affiliates. As described below under “– **Concerning the Obligated Affiliates**” additional Persons may become Obligated Affiliates or may be released as Obligated Affiliates under the Master Indenture.

Issuance of Master Debt Under the Master Indenture

Additional promissory notes, drafts, bonds, guarantees, and other obligations which evidence or are Debt (or related fee, expense, reimbursement, indemnity, or Financial Hedge obligations or any obligations to reimburse advances or make other payments under a letter of credit, surety bond, bond insurance policy, bond purchase agreement, direct purchase agreement, or similar credit or liquidity obligations, in each case whether entered into before, contemporaneously with, or after the incurrence of such Debt) of any Obligated Affiliate will become Master Debt under the Master Indenture and will be entitled to the benefits of the Master Indenture, *pari passu* with all other Outstanding Senior Master Debt or Outstanding Subordinate Master Debt, as applicable, from time to time

upon Application by the Combined Group Representative and receipt in every case by the Master Trustee of the following:

A. Resolution: a resolution of such issuing Obligated Affiliate authorizing the incurrence of such Debt (or related fee, expense, reimbursement, indemnity, or Financial Hedge obligation or any obligations to reimburse advances under a letter of credit, surety bond, bond insurance policy, bond purchase agreement, direct purchase agreement, or similar credit or liquidity obligations, in each case whether entered into before, contemporaneously with, or after the incurrence of such Debt);

B. Officer's Certificate: an Officer's Certificate of the Combined Group Representative, dated within 10 days of the date of such Application, (i) stating that no Default exists and that all conditions precedent provided for in the Master Indenture relating to the creation, assumption, or guarantee of such Debt (or any such related obligation) as Master Debt under the Master Indenture have been complied with, and (ii) specifying whether such proposed Master Debt shall constitute Senior Master Debt or Subordinate Master Debt; and

C. Opinion of Counsel: an Opinion of Counsel to the effect that:

(1) Compliance with Conditions: all conditions precedent provided for in the Master Indenture relating to the creation, assumption, or guarantee of such Debt (or any such related obligation) as Master Debt under the Master Indenture have been complied with, and

(2) Binding Parity Obligations: subject to customary exceptions, such Master Debt is a legal, valid, and binding obligation of such issuing Obligated Affiliate enforceable in accordance with its terms and entitled to the benefits of the Master Indenture.

Notwithstanding the foregoing, no Financial Hedge obligation (or any note evidencing the same) will be secured as Master Debt under the Master Indenture, *unless* (a) if such obligation requires the transfer of collateral thereunder, such Financial Hedge obligation (or the note evidencing the same) shall specifically acknowledge or provide that, if an Event of Default has occurred under the Master Indenture, or if such transfer would cause a Default under the Master Indenture, the obligation of the Member of the Combined Group that is a party to such Financial Hedge to transfer collateral will be suspended during the existence and continuance of such Event of Default or for so long as such transfer would cause a Default under the Master Indenture; *provided, however*, that such suspension of the obligation to transfer collateral will not affect any rights the counterparty to such Financial Hedge has (i) in or to any collateral previously transferred by a Member of the Combined Group which transfer did not conflict with the requirements of *Clause (a)* of this paragraph, or (ii) to declare or give notice of an event of default or termination event under such Financial Hedge due to the failure to transfer collateral, and (b) any right of any counterparty to such Financial Hedge obligation to benefit from the lien and security interest granted under the Master Indenture as security for any payment owed to such counterparty thereunder upon termination of such Financial Hedge obligation shall be Subordinate Master Debt under the Master Indenture during the existence and continuance of an Event of Default under the Master Indenture, or if such termination payment would cause a Default under the Master Indenture, except to the extent that such termination payment is insured by a financial guaranty insurance policy issued by an insurer the claims-paying ability or financial strength of which is rated at least "A" by each Rating Agency then rating such insurer.

Payment of Master Debt

Each Obligated Affiliate covenants to timely pay (i) all principal of and premium, if any, and interest and other debt service charges and payment obligations on the Outstanding Master Debt created or issued by it, and (ii) all charges, fees and expenses provided for under the Master Indenture related to such Master Debt in accordance with the terms thereof. Each Obligated Affiliate unconditionally and irrevocably guarantees the timely and full payment of all amounts payable, and the timely and full performance of all obligations performable, by each other Obligated Affiliate pursuant to the preceding sentence (including without limitation all amounts payable by such Obligated Affiliate in respect of Outstanding Master Debt previously or hereafter issued by it); *provided, however*, that such guarantee shall terminate upon the release of any such Person who is the guarantor as an Obligated Affiliate under the Master Indenture. Such guarantee is a guarantee of payment and not of collection.

Notwithstanding any provision in the Master Indenture to the contrary, no Obligated Affiliate will be liable for or required to pay, and neither the Master Trustee nor any Holder of Master Debt will be entitled to collect, any amount that (1) would be interest on any Master Debt issued by it and (2) would, when aggregated with all other interest payments made by such Obligated Affiliate on such Master Debt, exceed the maximum amount of interest which could be paid at the applicable lawful rate of non-usurious interest under applicable law. In the event that any Obligated Affiliate pays with respect to any Master Debt, or the Master Trustee or any Holder of Master Debt collects with respect to such Master Debt, interest in excess of that permitted by the preceding sentence to be paid or collected, then such excess will be deemed to have been the result of a mathematical error by the parties hereto and shall be refunded immediately to the appropriate Obligated Affiliate or, at the option of the Master Trustee or such Holder, applied against the unpaid principal balance of the Master Debt, and all provisions, and terms thereof respecting interest shall be immediately reformed and reduced, all without the necessity of execution of further documents, so as to comply fully with such applicable law. In determining the maximum amount of interest that the Holders of the Master Debt may lawfully contract for, charge, receive or reserve, all interest at any time paid or received under the Master Indenture, or contracted for or received in connection herewith, will be spread, allocated and amortized over the actual term of the Master Debt so as to produce a lawful rate and amount of interest, to the full extent permitted by applicable law.

Each Obligated Affiliate hereby agrees with each other Obligated Affiliate that each Obligated Affiliate will be primarily responsible and liable for payment of (a) the Master Debt issued by it, and (b) its Pro Rata Share (as defined below) of the payments required by *Clause (ii)* in the first paragraph of this section, and that, if any other Obligated Affiliate pays any of such obligations pursuant to this section, such other Obligated Affiliate will become subrogated to the rights of the Persons to whom such payments were made, and will be entitled to reimbursement of such payments from the Obligated Affiliate primarily responsible therefor subordinate in time and right of payment to the Outstanding Master Debt.

For purposes of this section, “*Pro Rata Share*” means, as to each Obligated Affiliate at the time of such determination the amount equal to: the product of (A) the payments described in *Clause (ii)* in the first paragraph of this section and (B) the ratio of all Outstanding Master Debt issued or entered into by such Obligated Affiliate to all Outstanding Master Debt.

Each Obligated Affiliate further agrees (i) to, (ii) to cause each of the other Members of the Combined Group within its control to, and (iii) to be caused to, observe, perform, and discharge all the applicable covenants, conditions, and obligations which are imposed on it or them by any and all mortgages, indentures, direct purchase agreements, reimbursement agreements, liquidity facilities, credit facilities, and other agreements evidencing, securing, or related to the Master Debt or pursuant to which such Master Debt is issued.

Maintenance of Properties

Each Obligated Affiliate will cause all its properties, used or useful, in the conduct of its business to be maintained and kept in good condition, repair, and working order, ordinary wear and tear and obsolescence excepted, and supplied with all necessary equipment. Each Obligated Affiliate will cause to be made all necessary repairs, renewals, replacements, betterments, and improvements thereof, all as in the judgment of such Obligated Affiliate may be necessary so that the business carried on in connection therewith may be properly and advantageously conducted at all times; *provided, however*, that any Obligated Affiliate may discontinue the operation and maintenance of any of its properties if such discontinuance is, in the judgment of such Person, desirable in the conduct of its respective business and not disadvantageous in any material respect to the Holders of Master Debt.

Rates

Each Obligated Affiliate shall (and shall cause each Restricted Affiliate within its control to) establish, charge, and collect rates, fees, and charges for goods and services furnished by it or by, or for the use of, the properties of such Persons such that the Debt Service Coverage Ratio is not less than 1.10. If in any Fiscal Year the Debt Service Coverage Ratio is less than 1.10, the Combined Group Representative shall engage a Management Consultant, which is not objected to by the Trustee, within 180 days after the close of such Fiscal Year to make, and each Member of the Combined Group is required to implement, recommended changes permitted under then

existing state and federal laws and regulations in the rates, fees, and charges or expenses or in such other affairs of such Member of the Combined Group such that the Debt Service Coverage Ratio for the current Fiscal Year will be at least 1.10.

If, in the opinion of the Management Consultant (a copy of which shall be delivered to the Master Trustee by the Combined Group Representative promptly after the Combined Group Representative's receipt of such opinion, and in any event within 30 days after its availability), the Combined Group is precluded by then existing federal or state laws or regulations from implementing the changes necessary to produce a Debt Service Coverage Ratio for the current Fiscal Year of at least 1.10, the Management Consultant will make, and each Member of the Combined Group is required to implement, recommended changes in the rates, fees, and charges or expenses or in such other affairs of each Member of the Combined Group such that the Consolidated Net Revenues as reflected in the applicable Financial Statements for the current Fiscal Year will be the maximum amount permitted under then existing state and federal laws and regulations.

The failure to maintain the Debt Service Coverage Ratio described above shall not be deemed a default under the Master Indenture if the Combined Group Representative complies with its obligations, as applicable, to engage a Management Consultant and the Members of the Combined Group comply with their obligations to implement, to the extent required by such paragraphs, changes recommended by such Management Consultant.

Notwithstanding the foregoing, if the Debt Service Coverage Ratio for any two consecutive Fiscal Years is less than 1.00, it shall constitute a Default under the Master Indenture.

No Limitations on Debt

Any Member of the Combined Group may incur Debt or other indebtedness without restriction.

Limitations on Liens

Except as otherwise permitted under the Master Indenture, no Obligated Affiliate will (nor will any Obligated Affiliate permit any Restricted Affiliate within its control to):

(A) **Create Liens or Security Interests:** grant, create, assume, or incur or suffer to be granted, created, assumed, or incurred or to exist any mortgage, lien, charge, or encumbrance of any kind upon, or pledge any of its properties of any character, including real, personal, tangible and intangible properties and revenues; or

(B) **Acquire Conditional Title:** acquire or agree to acquire any property of any character under any conditional sale agreement or other title retention agreement (including any lease in the nature of a title retention agreement); or

(C) **Consent to Subordination:** give its consent to the subordination of any right or claim of such Person to any right or claim of any other Person; or

(D) **Sign Financing Statement:** sign or file a financing statement under the Uniform Commercial Code which names such Person as a debtor or sign any security agreement authorizing any secured party thereunder to file such financing statement; or

(E) **Suffer Prior Indebtedness:** suffer to exist any Debt of such Person or any claims or demands against such Person, which, if unpaid, might (in the hands of the holder or any Person who has guaranteed the same or who has any right or obligation to purchase the same) by law or upon bankruptcy or insolvency or otherwise, be given any priority whatsoever over its general creditors.

Notwithstanding the foregoing, the following mortgages, liens, charges, pledges, security interests and encumbrances shall be permitted:

(1) ***Within the Combined Group.*** mortgages, liens, charges, pledges, or other security interests or encumbrances by any Member of the Combined Group as security for Debt owed to any other Member of the Combined Group;

(2) ***Permitted Encumbrances:*** Permitted Encumbrances;

(3) ***Purchase and Construction Money Liens:*** purchase or construction money mortgages, liens, pledges or security interests (which term for purposes of this *Clause (3)* shall include conditional sale agreements or other title retention agreements and leases in the nature of title retention agreements) upon or in property acquired or improved after the date of the Master Indenture, or mortgages, liens, pledges, or security interests existing in such property at the time of acquisition thereof (or, in the case of any Person which thereafter becomes a Member of the Combined Group, mortgages, liens, pledges, or security interests upon or in its real or personal property existing at the time such Person becomes a Member of the Combined Group), or replacements, extensions, or renewals of any such mortgages, liens, pledges, or security interests in connection with the replacement, extension, or renewal (with not more than a 2% increase in principal amount) of the Debt secured thereby, *provided* that no such mortgage, lien, pledge, or security interest extends or shall extend to or cover any property of any Member of the Combined Group other than the property then being acquired or constructed or on which improvements are being so constructed, and fixed improvements then or thereafter affixed thereto or erected thereon, rents, profits, and proceeds thereof, and insurance, tax, and related impounds;

(4) ***Master Indenture and Additional Security.*** any mortgage, lien, charge, pledge, or other security interest or encumbrance of the Master Indenture and, following such time as the Scott & White Series 2010 Bonds are no longer Outstanding under and as defined in the Scott & White Series 2010 Indenture, of any instrument given as additional security for the obligation of any Person to make payments in respect of any Outstanding Master Debt;

(5) ***Equal and Ratable Liens.*** any mortgage, lien, charge, pledge, or other security interest or encumbrance of any kind upon any property of any character of any Member of the Combined Group, or any conditional sale agreement or other similar title retention agreement with respect to any such property, if such Person makes effective provision, and (*unless* such mortgage, lien, charge, pledge, or other security interest or encumbrance is permitted by the Master Indenture) each applicable Obligated Affiliate covenants that in any such case it will make (or will cause a Restricted Affiliate within its control to make) effective provision, whereby the obligation of such Person to make payments in respect of the Outstanding Master Debt is directly secured by such mortgage, lien, charge, pledge, security interest, encumbrance, or agreement equally and ratably upon the same property or assets, or upon other property or assets with a fair market value at least equal to the book value of property or assets to be mortgaged, as determined by the Combined Group Representative, with any and all other obligations and indebtedness thereby secured so long as such other obligations or indebtedness is so secured;

(6) ***Donations and Gifts.*** security interests in pledges to make a donation, gift, or other charitable contribution to a Member of the Combined Group that secure Debt, the principal of which is fully secured by such security interests in pledges to make a donation, gift, or other charitable contribution to a Member of the Combined Group on or before the Stated Maturity of such Debt;

(7) ***Accounts Receivable.*** any mortgages, liens, charges, pledges, or other security interests or encumbrances of, on, or in accounts receivable and the proceeds thereof securing an obligation to repurchase or replace accounts receivable sold so long as (i) the maximum amount secured by such mortgage, lien, charge, pledge, or other security interest or encumbrance does not exceed the aggregate sales price of such accounts receivable received by the Member of the Combined Group selling the same by more than 20%, or (ii) the aggregate amount secured by such mortgages, liens, charges, pledges, or other security interests or encumbrances does not exceed 30% of the Combined Group Members' aggregate net patient accounts receivable and grant and other receivables, as reflected in the Financial Statements for the Fiscal Year preceding, or at the election of the Combined Group Representative any consecutive 12 month period ending within 180 days preceding, the date of creation of any such mortgage, lien, charge, pledge, or other security interest or encumbrance;

(8) **Reserve Funds.** any lien on, security interest in, or pledge of money or obligations set aside or deposited with a trustee to fund a depreciation, debt service, or other reserve fund with respect to Debt in accordance with the instrument under which such Debt may be secured;

(9) **Defeasance Deposits.** any lien on, security interest in, or pledge of money or obligations deposited with a trustee or escrow agent to cause Debt to be no longer outstanding in accordance with the instrument under which such Debt is issued;

(10) **Existing Liens.** any mortgage, lien, charge, pledge, or other security interest or encumbrance of, on, or in any property of a Member of the Combined Group which is existing on the effective date of the Master Indenture, any existing mortgage, lien, charge, pledge, or other security interest or encumbrance of, on, or in any property of an Obligated Affiliate on the date such Person becomes an Obligated Affiliate, and any existing mortgage, lien, charge, pledge, or other security interest or encumbrance of, on, or in any property of a Restricted Affiliate on the date such Person becomes a Restricted Affiliate, and any renewal of any lien described in this *Clause (10)* in connection with the replacement, extension, or renewal (without increase in principal amount) of the Debt secured thereby, provided that no such lien may be extended, renewed, or modified to spread to any property of such Person not subject to such lien on such effective date, except to the extent that such lien, as so extended, renewed, or modified, could have been granted or created under any provision of the Master Indenture;

(11) **Refunding Liens.** any mortgage, lien, charge, pledge, or other security interest or encumbrance of, on, or in any property of a Member of the Combined Group securing Debt that is incurred to refinance Debt previously secured by such mortgage, lien, charge, pledge, or other security interest or encumbrance, provided that the aggregate principal amount of such new Debt does not exceed the aggregate principal amount of such refinanced Debt;

(12) **Financial Hedge Collateral.** any lien or other encumbrance on cash and securities pledged to secure payments on a Financial Hedge obligation; provided, however, that the allowance for such a lien or other encumbrance pursuant to this *Clause (12)* shall not in and of itself operate to (i) create any lien or other security interest under the Master Indenture in favor of the counterparty to such Financial Hedge obligation, (ii) alter the priority under the Master Indenture of the payments on such Financial Hedge obligation, or (iii) alter any lien on or security interest in such cash and securities established by such Financial Hedge obligation; and

(13) **Basket.** any mortgage, lien, charge, pledge or other security interest or encumbrance of any kind if the Value of all property of the Combined Group subject to mortgages, liens, charges, pledges or other security interests or encumbrances incurred pursuant to this *Clause (13)* does not exceed 25% of the Value of all property of the Combined Group.

No Limitations on Disposition of Assets

Any Member of the Combined Group may make dispositions of its assets, including without limitation the Trust Estate and whether by conveyance, transfer, gift, lease, loan or otherwise, without restriction.

To Keep Books

Each Member of the Combined Group is required to keep and to cause each entity whose financial information is reflected in its Financial Statements to keep, at all times, books of record and accounts, in accordance with generally accepted accounting principles as of the date thereof (except (i) any such Person may provide for depreciation on the basis of historical cost adjusted for the effect of changes in the purchasing power of the dollar, and (ii) as may be disclosed in the notes to the Financial Statements to which reference is made under “**Financial Statements**” below).

Financial Statements

Under the Master Indenture, Financial Statements either provided to the Master Trustee or used in the determination, computation, certification and other actions taken under the Master Indenture (including calculations of Annual Debt Service Requirements, Maximum Annual Debt Service Requirements, Consolidated Net Revenues and Net Revenues) will be prepared in accordance with generally accepted accounting principles in the United States used in the preparation of the financial statements of BHCS for the fiscal year ended June 30, 2013, *subject, however,* to the following:

- (i) the Combined Group may, but will not be required to, record as revenue or receivables the estimated realizable value of pledges when such pledges are made;
- (ii) the Combined Group Representative, by providing an Officer's Certificate to the Master Trustee, may elect to utilize generally accepted accounting principles in the United States or any related standard or pronouncement in effect as of the date of a determination, certification, computation, or other action under the Master Indenture, until such time as such an election is made with respect thereto to utilize generally accepted accounting principles or any related standard or pronouncement coming into effect subsequent to the date of such prior election; and
- (iii) the Financial Statements may contain such departures as are necessary for the preparation of any special purpose financial statements delivered to the Master Trustee pursuant to the Master Indenture.

Insurance

Each Obligated Affiliate will at all times keep (and cause each Restricted Affiliate within its control to keep) all its property and operations of an insurable nature and of the character usually insured by companies operating similar properties and engaged in similar operations insured in amounts customarily carried, and against loss or damage from such causes as are customarily insured against, by similar companies. All such insurance is to be effected with responsible insurance carriers, except to the extent a program of self-insurance determined by the governing body of such Obligated Affiliate to be sufficient is in effect.

Each Obligated Affiliate is required to use proceeds of insurance received on account of any of its properties and compensation for any of its properties taken by eminent domain as it deems appropriate in light of its corporate purposes, as the same may be amended from time to time.

Consolidation, Merger, Conveyance, or Transfer

No Obligated Affiliate may consolidate or merge with any Person or convey or transfer its properties substantially as an entirety to any Person, unless either:

- (A) ***Obligated Affiliate is Surviving Entity:*** after giving effect to such consolidation, merger, conveyance or transfer, the successor, resulting, surviving or transferee Person is an Obligated Affiliate; or
- (B) ***Other Mergers, Etc.:*** all of the following conditions exist:
 - (1) ***Assumption of Master Indenture:*** the Person formed by such consolidation or merger, or the Person which acquires by conveyance or transfer the properties of such Obligated Affiliate substantially as an entirety, is a Person organized and existing under the laws of the United States of America or any state or the District of Columbia, and executes and delivers to the Master Trustee an agreement supplemental to the Master Indenture containing (x) a grant, conveyance, transfer, security agreement, and mortgage complying with the provisions of the Master Indenture and (y) an assumption by such Person of the obligations of such member of the Combined Group created by the Master Indenture and the performance and observance of every

covenant and condition of the Master Indenture to be performed or observed by the Obligated Affiliate which is the subject of such consolidation, merger, conveyance, or transfer;

(2) **Transaction Test:** the Transaction Test will be met immediately after giving effect to such consolidation, merger, conveyance, or transfer;

(3) **Opinion of Counsel:** the Obligated Affiliate which is the subject of such consolidation, merger, conveyance, or transfer shall have delivered to the Master Trustee an Opinion of Counsel to the effect that (i) such consolidation, merger, conveyance, or transfer will not adversely affect any exemption from federal income taxation of interest on any Outstanding Master Debt or any Debt secured by Outstanding Master Debt and otherwise entitled to such exemption, and (ii) all conditions precedent in the Master Indenture provided for relating to such transaction have been complied with; and

(4) **Officer's Certificate:** the Obligated Affiliate which is the subject of such consolidation, merger, conveyance, or transfer shall have delivered to the Master Trustee an Officer's Certificate stating that all conditions precedent in the Master Indenture provided for relating to such transaction have been complied with.

Upon any consolidation or merger of any Member of the Combined Group or any conveyance or transfer of its assets substantially as an entirety in accordance with the preceding paragraph, the survivor of such consolidation or merger, or the Person to which such conveyance or transfer is made, will succeed to, and be substituted for, and may exercise every right and power of, such Member under the Master Indenture.

No such conveyance or transfer of the assets of any such Member substantially as an entirety has the effect of releasing any such Member from any liability it may have under the Master Indenture for payment of the principal of (and premium, if any) and interest and other debt service charges and payment obligations on the Master Debt, unless (i) such conveyance or transfer is followed by the complete liquidation of such Member and substantially all of its assets immediately following such conveyance or transfer are assets of such successor Person received in such conveyance or transfer, or (ii) such Member is released from its obligations under the Master Indenture as described under the caption "**THE MASTER INDENTURE – Concerning the Obligated Affiliates – Withdrawal of Obligated Affiliates**" in this Appendix C.

Defaults and Remedies

Each of the following events constitutes an "**Event of Default**" under the Master Indenture:

(A) **Senior Interest Default:** default in the payment of any interest or similar debt service charges upon any Senior Master Debt when such interest or similar debt service charges become due and payable and following the expiration of the applicable period of grace therefor, if any, therein provided; or

(B) **Senior Principal Default:** default in the payment of the principal of (or premium, if any) or similar debt service charges or other payment obligation on any Senior Master Debt at its Maturity and following the expiration of the applicable period of grace therefor, if any, therein provided; or

(C) **Subordinate Interest Default:** if no Senior Master Debt is then Outstanding, default in the payment of any interest or similar debt service charges upon any Subordinate Master Debt when such interest or similar debt service charges become due and payable and following the expiration of the applicable period of grace therefor, if any, therein provided; or

(D) **Subordinate Principal Default:** if no Senior Master Debt is then Outstanding, default in the payment of the principal of (or premium, if any) or similar debt service charges or other payment obligation on any Subordinate Master Debt at its Maturity and following the expiration of the applicable period of grace therefor, if any, therein provided; or

(E) **Covenant Default:** default in the performance, or breach, of any covenant or warranty of any Member of the Combined Group in the Master Indenture (other than a covenant or warranty a default in the performance or breach of which is elsewhere in the Master Indenture specifically dealt with), and continuance of such default or breach for a period of 30 days after there has been given, by overnight delivery or by registered or certified mail, to the Combined Group Representative by the Trustee, or by the Holders of at least 10% in principal amount of the Outstanding Master Debt with a copy to the Trustee, a written notice specifying such default or breach and requiring it to be remedied and stating that such notice is a “**Notice of Default**” thereunder; *provided, however*, that if the default or breach stated in such notice cannot be corrected within such 30-day period, but can be reasonably expected to be corrected with due diligence, it will not constitute an Event of Default after such 30-day period if corrective action is instituted by the Member of the Combined Group which is in default or any other Member of the Combined Group within such 30-day period and diligently pursued until such default or breach is corrected; or

(F) **Involuntary Bankruptcy Proceeding:** either (1) the filing of a petition for relief against any Obligated Affiliate or Restricted Affiliate the assets of which exceed 10% of the assets of the Combined Group determined on a consolidated basis after eliminating intercompany items in accordance with generally accepted accounting principles, under the United States Bankruptcy Code, as now or hereafter constituted, or any other applicable federal or state law of similar import, or (2) the entry of a decree or order by a court having jurisdiction in the premises appointing a custodian, receiver, liquidator, assignee, trustee, sequestrator, or other similar official of or for any such Person or any substantial part of the properties of any such Person or ordering the winding up or liquidation of the affairs of any such Person, and in case of either *Clause (1)* or *(2)* the continuance of any such proceeding undismissed or any such decree or order unstayed and in effect for a period of 90 consecutive days; or

(G) **Voluntary Bankruptcy Proceeding:** the commencement by any Obligated Affiliate or Restricted Affiliate the assets of which exceed 10% of the assets of the Combined Group determined on a consolidated basis after eliminating intercompany items in accordance with generally accepted accounting principles, of a voluntary case under the United States Bankruptcy Code, as now or hereafter constituted, or any other applicable federal or state law of similar import, or the consent or acquiescence by any such Person to the commencement of a case under such Code or law or to the appointment of or taking possession by a custodian, receiver, liquidator, assignee, trustee, sequestrator or other similar official of any such Person or any substantial part of the properties of any such Person, or the making by any such Person of an assignment for the benefit of creditors, or the admission by any such Person in writing of its inability to pay its debts generally as they become due, or the taking of corporate action by any such Person in furtherance of any such action; or

(H) **Cross Default:** an event of default, as therein defined, or the declaration of acceleration under any instrument under which Master Debt may be created, assumed, or guaranteed, or under which Debt secured by Master Debt is issued, incurred, or secured, and the expiration of the applicable grace period, if any; *provided, however*, that if any such event of default or declaration of acceleration and its consequences under such instrument is cured or waived, then the Default thereunder by reason thereof will be deemed likewise to have been cured or waived; and *provided further* that any early termination of a Financial Hedge obligation that results in payments due thereunder will not constitute a declaration of acceleration under this *Subsection H* unless such early termination is the result of an event of default thereunder.

Except as otherwise provided in any Master Debt (or in any instrument under which such Master Debt is issued) as to principal thereof and accrued interest thereon, if an Event of Default occurs and is continuing, then and in every such case the Master Trustee or the Holders of not less than 25% in principal amount of the Outstanding Controlling Master Debt may declare the principal of all Master Debt to be due and payable immediately, by a notice in writing to the Combined Group Representative (and to the Trustee, if given by such Holders), and upon any such declaration such principal will become immediately due and payable. Notwithstanding the foregoing, the Master Trustee shall not accelerate all of the Master Debt and shall not make a claim against the Obligated Affiliates (other than an Obligated Affiliate which has issued Master Debt as to which an Event of Default exists) unless it first accelerates the Master Debt as to which an Event of Default exists (and, at the discretion of the Master Trustee, subject to the provisions of the Master Indenture, any other Master Debt issued by the same Obligated Affiliate) and

makes demand on a Business Day upon the Obligated Affiliate that issued the same for the payment in full thereof (and of interest, premium, if applicable, and other amounts in respect thereof) and fails to receive payment of the same on the Business Day following making such demand.

At any time after such a declaration of acceleration has been made, but before any judgment or decree for payment of money due on any Master Debt has been obtained by the Master Trustee, the Holders of a majority in principal amount of the Outstanding Controlling Master Debt (unless such declaration has been made only with respect to a portion of all Outstanding Master Debt, in which event only the Holders of a majority in principal amount of such portion of such Outstanding Master Debt) may, by written notice to the Combined Group Representative and the Master Trustee, rescind and annul such declaration and its consequences if:

(A) **Payment of Arrears:** the Combined Group Representative or the Obligated Affiliates have deposited with the Master Trustee a sum sufficient to pay:

(1) all overdue installments of interest and similar debt service charges on all Master Debt,

(2) all payment obligations on any Master Debt which has become due otherwise than by such declaration of acceleration and interest thereon at the rate or rates prescribed therefor in such Master Debt,

(3) to the extent that payment of such interest is lawful, interest upon overdue installments of interest at the rate or rates prescribed therefor in the Master Debt or by law if no provision is made therefor in the Master Debt, and

(4) all sums paid or advanced by the Master Trustee under the Master Indenture and the reasonable compensation, expenses, disbursements, and advances of the Master Trustee and its agents and counsel; and

(B) **Other Matters:** all Events of Default, other than the nonpayment of the principal of Master Debt which has become due solely by such declaration of acceleration, have been cured or have been waived as described under the caption “**THE MASTER INDENTURE – Waiver of Past Defaults**” in this Appendix C.

Application of Money Collected

Any money collected by the Master Trustee shall be applied in the following order, at the date or dates fixed by the Master Trustee and, in case of the distribution of such money on account of principal (or premium, if any) or interest or other debt service charges or payment obligations, upon presentation of the Master Debt and the notation thereon of the payment if only partially paid and upon surrender thereof if fully paid:

(A) **First:** to the payment of all amounts due the Master Trustee, the Master Debt Registrar, and the Authenticating Agent;

(B) **Second:** to the payment of the whole amount then due and unpaid upon the Outstanding Senior Master Debt, for principal (and premium, if any) and interest and other debt service charges and payment obligations, with interest (to the extent that such interest has been collected by the Master Trustee or a sum sufficient therefor has been so collected and payment thereof is legally enforceable at the respective rate or rates prescribed therefor in the Senior Master Debt of the several series) on overdue principal (and premium, if any) and on overdue installments of interest and other debt service charges and payment obligations; and in case such proceeds shall be insufficient to pay in full the whole amount so due and unpaid upon such Senior Master Debt, then to the payment of such principal, premium, interest, and other debt service charges and payment obligations, without any preference or priority, ratably according to the aggregate amount so due;

(C) **Third:** to the payment of the whole amount then due and unpaid upon the Outstanding Subordinate Master Debt, for principal (and premium, if any) and interest and other debt service charges and payment obligations, with interest (to the extent that such interest has been collected by the Master Trustee or a sum sufficient therefor has been so collected and payment thereof is legally enforceable at the respective rate or rates prescribed therefor in the Subordinate Master Debt of the several series) on overdue principal (and premium, if any) and on overdue installments of interest and other debt service charges and payment obligations; and in case such proceeds shall be insufficient to pay in full the whole amount so due and unpaid upon such Subordinate Master Debt, then to the payment of such principal, premium, interest, and other debt service charges and payment obligations, without any preference or priority, ratably according to the aggregate amount so due; and

(D) **Fourth:** to the payment of the remainder, if any, to the Obligated Affiliates as their interests may appear or to whomsoever may be lawfully entitled to receive the same or as a court of competent jurisdiction may direct.

Limitation on Suits

No Holder of any Master Debt has have any right to institute any proceeding, judicial or otherwise, under or with respect to the Master Indenture, or for the appointment of a receiver or trustee or for any other remedy under the Master Indenture, *unless*:

(A) **Notice to Trustee:** such Holder has previously given written notice to the Master Trustee of a continuing Event of Default;

(B) **Request of Trustee:** the Holders of not less than 25% in principal amount of the Outstanding Controlling Master Debt have made written request to the Master Trustee to institute proceedings in respect of such Event of Default in its own name as Master Trustee under the Master Indenture;

(C) **Offer of Indemnity:** such Holder or Holders have offered to the Master Trustee reasonable indemnity against the costs, expenses, and liabilities to be incurred in compliance with such request;

(D) **Failure to Proceed:** the Master Trustee for 60 days after the receipt of such notice, request, and offer of indemnity has failed to institute any such proceeding; and

(E) **No Inconsistent Direction:** no direction inconsistent with such written request has been given to the Master Trustee during such 60-day period by the Holders of a majority in principal amount of the Outstanding Controlling Master Debt;

No one or more Holders of Master Debt has any right in any manner whatever by virtue of, or by availing of, any provision of the Master Indenture to affect, disturb, or prejudice the rights of any other Holders of Master Debt, or to obtain or to seek to obtain priority or preference over any other Holders, or to enforce any right under the Master Indenture, except in the manner provided in the Master Indenture and for the equal and ratable benefit of all Outstanding Master Debt and the Holders thereof.

Control by Holders of Master Debt

The Holders of a majority in principal amount of the Outstanding Controlling Master Debt have the right, during the continuance of an Event of Default:

(A) **To Require Enforcement:** to require the Master Trustee to proceed to enforce the Master Indenture by judicial proceedings or for the enforcement of the payment of the Master Debt or by foreclosure of the lien of the Master Indenture, or by the exercise of the power of sale thereby conferred, any one or more; and

(B) **To Direct Proceedings:** to direct the time, method, and place of conducting any proceeding for any remedy available to the Master Trustee, or exercising any trust or power conferred upon the Master Trustee under the Master Indenture, *provided* that:

(1) such direction must not be in conflict with any rule of law or the Master Indenture,

(2) the Master Trustee may take any other action deemed proper by the Master Trustee which is not inconsistent with such direction, and

(3) the Master Trustee must not have determine that the action so directed would be unjustly prejudicial to the Holders not taking part in such direction.

Waiver of Past Defaults

Before any judgment or decree for payment of money due has been obtained by the Master Trustee, the Holders of not less than a majority in principal amount of the Outstanding Controlling Master Debt may, by Act of such Holders delivered to the Master Trustee and the Combined Group Representative, on behalf of the Holders of all the Master Debt, waive any past Default under the Master Indenture and its consequences, *except* a Default:

(A) in the payment of the principal of (or premium, if any) or interest or other debt service charges or payment obligations on any Master Debt, or

(B) in respect of a covenant or provision of the Master Indenture which cannot be modified or amended without the consent of the Holders of all Outstanding Master Debt affected.

Upon any such waiver, such Default will cease to exist, and any Event of Default arising therefrom will be deemed to have been cured, for every purpose of the Master Indenture; but no such waiver will extend to any subsequent or other Default or Event of Default or impair any right consequent thereon.

Default Not Affecting All Master Debt

In case there occurs and is continuing an Event of Default affecting the rights of the Holders of Master Debt of any one or more series that does not similarly affect the rights of Holders of all other series of Master Debt at the time Outstanding, then whatever action may or is required to be taken under the Master Indenture upon the occurrence of such Event of Default by or upon the request of the Holders of a specified percentage in principal amount of the Controlling Master Debt then Outstanding (including without limitation any declaration that the principal of Outstanding Master Debt is due and payable immediately) may or shall be taken in respect of the Master Debt then Outstanding of the series as to which such Default shall have been made, by or upon the request of the Holders of the same percentage in principal amount of the Controlling Master Debt of such series then Outstanding; *provided, however*, that if such Event of Default only affects the rights of the Holders of Subordinate Master Debt while any Senior Master Debt is Outstanding, any action taken pursuant to the Master Indenture shall remain subject to the rights granted to the Holders of the Controlling Master Debt pursuant to the Master Indenture.

In particular, and without limiting the generality of the foregoing, the Master Trustee may, in its sole discretion, determine that an Event of Default caused by the act, omission or failure of one Person affects primarily the rights of the Holders of Master Debt issued by such Person, or affects primarily the rights of the Holders of Senior Master Debt or Subordinate Master Debt, and does not similarly affect the rights of Holders of other Master Debt.

Financial Hedge Obligation Payments

Subject to the definition of “*Outstanding*” under the Master Indenture, (a) regularly scheduled or periodic payments owed to a counterparty under a Financial Hedge obligation that is evidenced by or secured as Master Debt will be treated as payments of interest on such Master Debt for purposes of Events of Default and remedies under

the Master Indenture, and (b) termination payments, settlement payments, or other payments not included in *Clause (a)* above owed to a counterparty under a Financial Hedge obligation that is evidenced by or secured as Master Debt will be treated as payments of principal on such Master Debt for purposes of Events of Default and remedies under the Master Indenture.

Resignation or Removal of the Master Trustee

The Master Trustee may resign at any time by giving written notice thereof to the Combined Group Representative. If a successor Master Trustee has not accepted appointment within 30 days after the Master Trustee gives such notice of resignation, the resigning Master Trustee may petition any court of competent jurisdiction for the appointment of a successor Master Trustee.

The Master Trustee may be removed at any time (1) by Act of the Holders of a majority in principal amount of the Outstanding Controlling Master Debt, delivered to the Master Trustee and the Combined Group Representative, or (2) unless a Default shall exist under the Master Indenture, by Order of the Combined Group Representative. In addition, the Master Trustee may be removed by the Combined Group Representative or (upon the petition of any Holder of Master Debt who has been a bona fide Holder thereof for at least six months) by a court of competent jurisdiction, if at any time the Master Trustee ceases to be eligible under the Master Indenture and fails to resign after written request by the Combined Group Representative, any Obligated Affiliate or any such Holder of Master Debt, or if the Master Trustee becomes incapable of acting or is adjudged a bankrupt or insolvent or a receiver of the Master Trustee or of its property is appointed or any public officer takes charge or control of the Master Trustee or of its property or affairs for the purpose of rehabilitation, conservation, or liquidation.

Neither the resignation nor removal of the Master Trustee will become effective until the acceptance of appointment by a successor Master Trustee under the Master Indenture.

If the Master Trustee resigns, is removed, or becomes incapable of acting, or if a vacancy occurs in the office of Master Trustee for any cause, the Combined Group Representative is required to promptly appoint a successor Master Trustee. In case all or substantially all of the Trust Estate is in the possession of a receiver or trustee lawfully appointed, such receiver or trustee, by written instrument, may similarly appoint a successor to fill such vacancy until a new Master Trustee is appointed by the Holders of Master Debt. If, within one year after such resignation, removal or incapability, or the occurrence of such vacancy, a successor Master Trustee is appointed by the Holders of a majority in principal amount of the Outstanding Controlling Master Debt and delivered to the Combined Group Representative and the retiring Master Trustee, then the successor Master Trustee so appointed will become the successor Master Trustee and supersede the successor Master Trustee appointed by the Combined Group Representative. If no successor Master Trustee has been appointed by the Combined Group Representative or the Holders of Controlling Master Debt, any Holder of Master Debt who has been a bona fide Holder thereof for at least six months may petition any court of competent jurisdiction for the appointment of a successor Master Trustee.

The Combined Group Representative is required to give notice of each resignation and each removal of the Master Trustee and each appointment of a successor Master Trustee to the Holders of Master Debt.

Concerning the Master Trustee

The Master Indenture contains various limitations on the liability of the Master Trustee. The Master Trustee is not liable for any error of judgment made in good faith by a responsible officer, unless the Master Trustee was negligent in ascertaining the pertinent facts. The Master Trustee is not liable for any action taken or omitted to be taken by it in good faith in accordance with the direction of the Holders of a majority in principal amount of the Outstanding Controlling Master Debt relating to the time, method, and place of conducting any proceeding for any remedy available to the Master Trustee, or exercising any trust or power conferred upon the Master Trustee, under the Master Indenture. No provision of the Master Indenture requires the Master Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of its duties under the Master Indenture or in the exercise of any of its rights or powers, if it has reasonable grounds for believing that repayment of such funds or indemnity satisfactory to it against such risk or liability is not assured. In the absence of bad faith on its part, the Master Trustee may conclusively rely, as to the truth of statements and the correctness of the opinions expressed

therein, upon certificates or opinions furnished to the Master Trustee and conforming to the requirements of the Master Indenture. If an Event of Default under the Master Indenture has occurred and is continuing, the Master Trustee is required to exercise the rights and powers vested in it by the Master Indenture, and to use the same degree of care and skill in such exercise, as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

Amendments and Waivers

Without the consent of any Holders of Master Debt, the Combined Group Representative and the Master Trustee may from time to time enter into one or more indentures supplemental to the Master Indenture for any of the following purposes:

(A) ***To Restrict Master Debt:*** to add to the conditions, limitations, and restrictions on the authorized amount, terms, or purposes of Debt or other obligations which may be qualified as Master Debt under the Master Indenture, as set forth in the Master Indenture, additional conditions, limitations, and restrictions thereafter to be observed; or

(B) ***To Evidence Master Debt:*** to evidence that Debt or other obligations have become Master Debt under the Master Indenture in accordance with the provisions of the Master Indenture; or

(C) ***To Amend Prospectively:*** to modify or eliminate any of the terms of the Master Indenture; *provided, however,* that such supplemental indenture shall expressly provide that any such modifications or eliminations shall become effective only when there is no Master Debt Outstanding of any series created prior to the execution of such supplemental indenture which would be affected by such supplemental indenture; or

(D) ***To Add or Remove Obligated Affiliates and Restricted Affiliates:*** to evidence the assumption by any Affiliate of the covenants and warranties of an Obligated Affiliate or a Restricted Affiliate under the Master Indenture or the release of an Obligated Affiliate or a Restricted Affiliate from such status in accordance with the provisions of the Master Indenture; or

(E) ***To Evidence Succession:*** to evidence the succession of another Person to the Combined Group Representative, any Obligated Affiliate or any Restricted Affiliate and the assumption by any such successor of the covenants of such Person contained in the Master Indenture in accordance with the provisions of the Master Indenture; or

(F) ***To Add Restrictive Covenants:*** to add to the covenants of the Combined Group Representative, any Obligated Affiliate or any Restricted Affiliate for the benefit of the Holders of all or any series of Master Debt (including the establishment of one or more funds or accounts under the Master Indenture) or to surrender any right or power conferred upon the Combined Group Representative, any Obligated Affiliate or any Restricted Affiliate; or

(G) ***To Qualify under Trust Indenture Act:*** to modify, eliminate, or add to the provisions of the Master Indenture to the extent necessary to effect the qualification of the Master Indenture under the Trust Indenture Act of 1939, as in force at the date of such qualification, or under any similar federal statute enacted after the date of the Master Indenture, and to add to the Master Indenture such other provisions as may be expressly permitted by the Trust Indenture Act of 1939, *excluding, however,* the provisions referred to in Section 316(a)(2) of the Trust Indenture Act of 1939 as in effect at the date as of execution of the Master Indenture or any corresponding provision in any similar federal statute thereafter enacted; or

(H) ***To Grant or Adjust Liens:*** *subject* to the limitations on liens provided in the Master Indenture, to grant a lien on or security interest in any property as security for payment of the Master Debt, to correct or amplify the description of any property at any time subject to such lien or security interest, or better to assure, convey, and confirm unto the Master Trustee any property subject or required to be subjected to such lien or security interest; or

(I) **To Respond to Changes in GAAP:** to modify any provision of the Master Indenture in order to avoid any unintended impact on the compliance by the Combined Group or, if applicable, the System, with financial covenants following any change in generally accepted accounting principles that would affect the computation of any financial ratio or other financial computation under the Master Indenture, *if* the Master Trustee is provided with (1) an Officer's Certificate of the Combined Group Representative stating that the amendment is intended to avoid a change (positive or negative) in the Combined Group's or, if applicable, the System's future compliance with any minimum or maximum financial ratio or other metric required by the Master Indenture when applied to the same economic facts and (2) a certificate of an Accountant stating that, if the changed accounting principles and amendment were in effect in the prior Fiscal Year, no minimum or maximum financial ratio or other metric imposed by the Master Indenture would have been complied with by a greater margin; or

(J) **Establishment of Funds:** to establish any one or more funds under the Master Indenture as provided in the Master Indenture; or

(K) **To Make Non-Adverse Changes:** to cure any ambiguity, to correct or supplement any provision in the Master Indenture which may be inconsistent with any other provision in the Master Indenture, or to make any other provisions with respect to matters or questions arising under the Master Indenture, which shall not be inconsistent with the provisions of the Master Indenture, *provided* such action shall not adversely affect the interests of the Holders of Master Debt.

With the consent of the Holders of not less than a majority in principal amount of the Outstanding Controlling Master Debt (by Act of such Holders delivered to the Combined Group Representative and the Master Trustee), the Combined Group Representative and the Master Trustee may enter into an indenture or indentures supplemental to the Master Indenture for the purpose of adding any provisions to or changing in any manner or eliminating any provision of the Master Indenture or of modifying in any manner the rights of the Holders of Master Debt under the Master Indenture; but no such supplemental indenture, without the consent of each Holder of Outstanding Master Debt affected thereby, may:

(A) **Impair Payment Rights:** impair the right to institute suit for the enforcement of the payment of the principal of (and premium, if any) or interest or other debt service charges or payment obligations on any Master Debt on or after the Maturity or Stated Maturity thereof (or, in the case of redemption, on or after the date for redemption); or

(B) **Enfranchise Disenfranchised Holders:** modify or alter the provisions of *Clause (i)* of the proviso to the definition in the Master Indenture of the term "*Outstanding*"; or

(C) **Modify Amendment and Waiver Provisions:** modify any of the provisions of the Master Indenture concerning approval of supplemental indentures or waiver of certain covenants, *except* to increase any percentage provided thereby or to provide that certain other provisions of the Master Indenture cannot be modified or waived without the consent of each Holder of Master Debt affected thereby; or

(E) **Subordinate Lien:** permit the creation of any lien or claim ranking prior to or on a parity with the lien or claim of the Master Indenture with respect to any of the Trust Estate, except as permitted as described under the caption "**THE MASTER INDENTURE – Limitations on Liens**" in this Appendix C, or terminate the lien of the Master Indenture on any property at any time subject hereto except as permitted hereby, or deprive any Holder of Master Debt of the security afforded by the lien of the Master Indenture, or modify or alter the provisions described under the caption "**THE MASTER INDENTURE – Limitations on Liens**" in this Appendix C to permit any lien or security interest which secures some, but less than all, Master Debt except as therein permitted, or, without the consent of the Holders of 66.66% of the principal amount of Outstanding Controlling Master Debt, otherwise modify or alter such provisions.

The Master Trustee may in its discretion determine whether or not any Master Debt would be affected by any supplemental indenture and any such determination will be conclusive upon every Holder of Master Debt. The Master Trustee will not be liable for any such determination made in good faith.

The Master Indenture further provides that it is not necessary for any act of Holders of Master Debt to approve the form of any proposed supplemental indenture, but it is sufficient if such act approves the substance thereof.

Defeasance of the Master Indenture

The Master Indenture, and the lien, rights and interests created thereby will terminate, at the request of the Combined Group Representative, when the following conditions exist:

- (A) no Master Debt remains Outstanding;
- (B) the Obligated Affiliates have paid or caused to be paid all sums payable under the Master Indenture by such Persons other than the Master Debt; and
- (C) there has been delivered to the Master Trustee an Officer's Certificate of the Combined Group Representative, and an Opinion of Counsel, each of which are required to state that all conditions precedent in the Master Indenture provided for relating to the satisfaction and discharge thereof have been complied with.

Concerning the Obligated Affiliates

Admission of Obligated Affiliates. A Person may become an Obligated Affiliate if:

(A) the Person proposing to become an Obligated Affiliate executes and delivers to the Master Trustee an indenture supplemental to the Master Indenture which evidences the agreement of such Person while such Person is an Obligated Affiliate (1) jointly and severally to assume or guarantee on the terms provided in the Master Indenture the obligation to pay all Master Debt then Outstanding and thereafter incurred and (2) to observe and perform each obligation of an Obligated Affiliate set forth in the Master Indenture;

(B) the Combined Group Representative has delivered to the Master Trustee an Officer's Certificate (i) consenting to the inclusion of such Person as an Obligated Affiliate, (ii) stating that the admission and such supplemental indenture comply with the Master Indenture and that all conditions precedent provided in the Master Indenture relating to such admission have been complied with, and (iii) demonstrating that the Transaction Test will be met immediately after giving effect to such admission; and

(C) the Combined Group Representative has delivered to the Master Trustee an Opinion of Counsel to the effect that (i) the admission of such Person as an Obligated Affiliate will not adversely affect the exclusion from gross income of interest under the Internal Revenue Code of 1986, as amended, on any Debt secured by Outstanding Master Debt and otherwise entitled to such exemption, (ii) the admission of such Person as an Obligated Affiliate will not adversely affect the enforceability of the Master Indenture against any current Obligated Affiliate, (iii) the supplemental indenture required by the Master Indenture, and the Master Indenture as so supplemented, each constitute the legal, valid and binding obligation of such Person, enforceable in accordance with their respective terms and subject to customary exceptions, and (iv) all conditions precedent provided in the Master Indenture relating to such admission have been complied with.

Withdrawal of Obligated Affiliates. Any Obligated Affiliate may, upon Request to the Master Trustee and the Combined Group Representative (unless such Obligated Affiliate is the Combined Group Representative), withdraw as an Obligated Affiliate, and the Master Trustee, at such withdrawing Obligated Affiliate's Request and expense, is required to execute and deliver an appropriate instrument releasing such Obligated Affiliate from any liability or obligation under the provisions of the Master Indenture, provided that:

(A) the Combined Group Representative shall have delivered to the Master Trustee an Officer's Certificate (i) consenting to the withdrawal of such Person as an Obligated Affiliate, (ii) stating that all conditions precedent provided in the Master Indenture relating to such withdrawal have been complied with, and (iii) demonstrating that the Transaction Test will be met immediately after giving effect to such withdrawal; and

(B) the Combined Group Representative shall have delivered to the Master Trustee an Opinion of Counsel to the effect that (i) the withdrawal of such Person as an Obligated Affiliate will not adversely affect the exclusion from gross income of interest under the Internal Revenue Code of 1986, as amended, on any Debt secured by Outstanding Master Debt and otherwise entitled to such exemption, and (ii) all conditions precedent provided in the Master Indenture relating to such withdrawal have been complied with.

Any Person that has withdrawn as an Obligated Affiliate may again become an Obligated Affiliate in accordance with the provisions of the Master Indenture.

Concerning the Restricted Affiliates

Designation as a Restricted Affiliate. Any Affiliate of any Obligated Affiliate that satisfies the conditions set forth in the definition of "*Restricted Affiliate*" in the Master Indenture shall become a Restricted Affiliate upon Request of the Combined Group Representative that such Affiliate become a Restricted Affiliate accompanied by:

(A) a written undertaking for the benefit of the Combined Group and the Master Trustee executed by such Person evidencing the agreement of such Person to observe and perform the obligations of a Restricted Affiliate in accordance with the Master Indenture, and to comply with all covenants in the Master Indenture which apply to Restricted Affiliates for so long as such Person remains a Restricted Affiliate; and

(B) an Opinion of Counsel to the effect that any transfers of money by such proposed Restricted Affiliate to an Obligated Affiliate to the extent required under the Master Indenture are permissible under the laws of the jurisdiction in which such proposed Restricted Affiliate is organized (1) except to the extent that such transfers would (i) render such proposed Restricted Affiliate insolvent, (ii) conflict with any applicable statutory provision relating to fraudulent transfers, and (iii) in the case of any transfer by dividend, violate applicable statutory restrictions on the declaration and payment of dividends by such proposed Restricted Affiliate, and (2) in the case of any proposed Restricted Affiliate which is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, assuming that such Restricted Affiliate continues to maintain its status as an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

Release of a Restricted Affiliate. A Restricted Affiliate shall be released from its obligations and status as a Restricted Affiliate either upon (i) becoming an Obligated Affiliate or (ii) delivery to the Master Trustee of an Officer's Certificate of the Combined Group Representative requesting that such Person no longer be a Restricted Affiliate and be released from its obligations and status as a Restricted Affiliate under the Master Indenture, stating that all conditions precedent provided for under the Master Indenture relating to the release of such Person as a Restricted Affiliate have been complied with, and stating that were such Person released as a Restricted Affiliate on the date of such Officer's Certificate, no Default would arise out of such release.

Payments by Restricted Affiliates. Each Restricted Affiliate agrees with, and for the benefit of, each Obligated Affiliate to:

(A) make to such Obligated Affiliate contributions, advances or loans the repayment of which is subordinate in time and right of payment to the Outstanding Master Debt, to the extent of funds lawfully available for such purpose, to the extent necessary to provide for the due and punctual payment of the principal of (and premium, if any) and interest and other debt service charges and payment obligations on all Outstanding Master Debt in accordance with the terms of the Master Indenture whether such Obligated

Affiliate is the primary obligor or a guarantor with respect to such Master Debt; *provided, however*, that no Restricted Affiliate shall be required to make any transfer that would likely, in the Opinion of Counsel satisfactory to such Obligated Affiliate and the Master Trustee, cause the members of the governing body of such Restricted Affiliate to incur personal liability to other creditors of such Restricted Affiliate as a result of such transfer; and

(B) perform all other covenants and comply with all other restrictions applicable to such Restricted Affiliate under the Master Indenture.

Replacement Master Indenture

Upon the written request of the Combined Group Representative under the Master Indenture and the delivery of a Replacement Master Indenture, the Master Trustee is required to accept the substitution of such Replacement Master Indenture and the liens, rights, and interests created under the Master Indenture shall cease, determine, and become null and void and each Member of the Combined Group, the Master Trustee and each co-trustee and separate trustee, if any, then acting as such is required to, at the expense of the Combined Group Representative, execute and deliver a termination statement and such instruments of satisfaction and discharge as may be necessary and pay, assign, transfer and deliver on the order of the Combined Group Representative all cash, securities, and other personal property then held by it under the Master Indenture as part of the Trust Estate upon delivery to the Master Trustee of an Opinion of Counsel to the effect that:

(A) the Replacement Master Indenture has been duly authorized, executed and delivered by, and constitutes the legal, valid, binding and enforceable obligation of, those Persons who are parties to, or who otherwise have become jointly and severally obligated under, the Replacement Master Indenture, subject to customary exceptions;

(B) the acceptance of the Replacement Master Indenture and the release of the Master Indenture will not adversely affect any exemption from federal income taxation of interest on any Debt secured by Master Debt and otherwise entitled to such exemption; and

(C) all requirements and conditions in the Master Indenture to the acceptance of the Replacement Master Indenture and the release of the Master Indenture have been complied with and satisfied.

Upon the acceptance of a Replacement Master Indenture and the release of the Master Indenture as described above, all Outstanding Master Debt under the Master Indenture shall be deemed to be a note or obligation issued under and entitled to the security and benefits of the Replacement Master Indenture without the necessity of any amendment, exchange or replacement of such Master Debt, unless and until such Master Debt is exchanged for or replaced with a note or obligation issued under and entitled to the benefits of the Replacement Master Indenture in accordance with the terms and conditions of the Replacement Master Indenture.

Upon the acceptance of a Replacement Master Indenture and the release of the Master Indenture as described above, the Master Trustee will give written notice of such acceptance and release to the Holders of the Master Debt then Outstanding and, upon written request of any such Holder, provide a copy of the Replacement Master Indenture.

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APPENDIX D
FORM OF BOND COUNSEL OPINION

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April 19, 2016

WE HAVE ACTED AS BOND COUNSEL to Tarrant County Cultural Education Facilities Finance Corporation (the “*Issuer*”) in connection with the issuance of its Hospital Revenue Bonds (Baylor Scott & White Health Project) Series 2016A (the “*Bonds*”). The Bonds are issuable in fully registered form in the denominations stated therein. The Bonds are being issued in the aggregate principal amount of \$373,340,000, to mature on November 15 of the years and in the aggregate amounts stated in the Indenture hereinafter referred to, unless sooner called for redemption prior to their scheduled maturity in accordance with the terms and conditions stated therein, and bear interest from the date of initial issue, or from the most recent interest payment date therefor to which interest has been paid or duly provided for, at per annum rates of interest stated in the Indenture for the Bonds of each stated maturity. The Bonds are limited obligations payable by the Issuer solely from and to the extent of the property of the Issuer pledged and collaterally assigned to The Bank of New York Mellon Trust Company, National Association, as trustee, under an Indenture of Trust and Security Agreement, dated as of April 1, 2016 (the “*Indenture*”), from the Issuer, including loan payments to be made by Baylor Scott & White Holdings, a Texas nonprofit corporation (“*Holdings*”), pursuant to a Loan Agreement, dated as of April 1, 2016 (the “*Loan Agreement*”), between the Issuer and Holdings.

WE HAVE EXAMINED the Bonds, executed or certified to our satisfaction. We have also examined, and in expressing the opinions hereinafter described we rely upon, the representations, warranties, and covenants of the parties thereto contained in the Loan Agreement and the Indenture; a special report of Causey Demgen & Moore P.C., certified public accountants and consultants; original or certified copies of the proceedings of the board of directors of the Issuer authorizing issuance of the Bonds; certificates of the Issuer relating to the expected use, expenditure, and investment of certain funds of the Issuer and Holdings and relating to other material facts within the sole knowledge of the Issuer which we have not independently verified; certificates, resolutions, and representations of Holdings, including certificates and representations with respect to certain material facts within the sole knowledge of Holdings relating to, among other matters, the status of the Bonds under section 103 of the Internal Revenue Code of 1986, as amended to the date hereof (the “*Code*”), and of Holdings and the Holdings Affiliates (defined below) as exempt organizations under section 501(c)(3) of the Code, which we have not independently verified; and such other material and such matters of law as we deem relevant to the matters discussed below. In such examination, we have assumed the authenticity of all documents submitted to us as originals, the conformity to original copies of all documents submitted to us as certified copies, and the accuracy of the statements contained in such certificates and reports. For purposes of this opinion, Holdings Affiliates is defined as Baylor All Saints Medical Center, a Texas nonprofit corporation, Baylor Health Care System, a Texas nonprofit corporation, Baylor Medical Center at Waxahachie, a Texas nonprofit

Re: Tarrant County Cultural Education Facilities Finance Corporation Hospital
Revenue Bonds (Baylor Scott & White Health Project) Series 2016A

corporation, Baylor Regional Medical Center at Grapevine, a Texas nonprofit corporation, Baylor Medical Centers at Garland and McKinney, a Texas nonprofit corporation, Baylor Regional Medical Center at Plano, a Texas nonprofit corporation, Baylor Scott & White Health, a Texas nonprofit corporation, Baylor University Medical Center, a Texas nonprofit corporation, Hillcrest Baptist Medical Center, a Texas nonprofit corporation, Scott & White Clinic, a Texas nonprofit corporation, Scott & White Continuing Care Hospital, a Texas nonprofit corporation, Scott & White Healthcare, a Texas nonprofit corporation, Scott & White Hospital – College Station, a Texas nonprofit corporation, Scott & White Hospital – Round Rock, a Texas nonprofit corporation, Scott & White Memorial Hospital, a Texas nonprofit corporation, and any other affiliate of Holdings that owns, operates or uses any portion of the facilities financed or refinanced with the proceeds of the Bonds (collectively, the “*Holdings Affiliates*”).

WE ARE OF THE OPINION, based upon such examination, that, under applicable law of the State of Texas and federal law of the United States of America in force and effect on the date hereof, the Bonds have been duly authorized, executed, authenticated, and delivered and are valid and legally binding limited obligations of the Issuer payable from the sources, and enforceable in accordance with the terms and conditions, described herein and therein, except to the extent that the enforcement thereof may be affected by bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors’ rights or the exercise of judicial discretion in accordance with general principles of equity.

WE ARE ALSO OF THE OPINION, based upon the foregoing, and assuming continuing compliance after the date hereof with certain provisions of the Indenture and the Loan Agreement affecting the status of the interest on the Bonds under section 103 of the Code and of Holdings and the Holdings Affiliates as exempt organizations under section 501(c)(3) of the Code, that under existing law, interest on the Bonds (1) will be excludable from the gross income, as defined in section 61 of the Code, of the owners thereof for federal income tax purposes, pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions, and (2) will not be included in computing the federal alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations.

WE CALL TO YOUR ATTENTION THAT interest on Bonds owned by a corporation (other than an “S corporation” or a qualified mutual fund, real estate mortgage investment conduit (REMIC), real estate investment trust (REIT), or financial asset securitization investment trust (FASIT)) will be included in its adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation. A corporation’s alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code is computed.

WE EXPRESS NO OPINION with respect to any other federal, state, or local tax consequences under present law or any proposed legislation resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies,

Re: Tarrant County Cultural Education Facilities Finance Corporation Hospital
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certain "S corporations" with "subchapter C" earnings and profits, certain foreign corporations doing business in the United States, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for an earned income tax credit, owners of an interest in a FASIT, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, such tax-exempt obligations.

OUR OPINIONS ARE BASED on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

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APPENDIX E
FORM OF CONTINUING DISCLOSURE AGREEMENT

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CONTINUING DISCLOSURE AGREEMENT

This Continuing Disclosure Agreement (the “Disclosure Agreement”) is executed and delivered by Baylor Scott & White Holdings, a Texas nonstock nonprofit corporation duly organized and existing under the laws of the State of Texas (the “Corporation”), on behalf of itself and Baylor Scott & White Health, a Texas nonprofit corporation, Baylor Health Care System, a Texas nonprofit corporation, Baylor University Medical Center, a Texas nonprofit corporation, Baylor All Saints Medical Center, a Texas nonprofit corporation, Baylor Regional Medical Center at Grapevine, a Texas nonprofit corporation, Baylor Medical Center at Waxahachie, a Texas nonprofit corporation, Baylor Regional Medical Center at Plano, a Texas nonprofit corporation, Baylor Medical Centers at Garland and McKinney, a Texas nonprofit corporation, Scott & White Healthcare, a Texas nonprofit corporation, Scott & White Memorial Hospital, a Texas nonprofit corporation, Scott & White Clinic, a Texas nonprofit corporation, Scott & White Hospital – Round Rock, a Texas nonprofit corporation, Scott & White Continuing Care Hospital, a Texas nonprofit corporation, Scott & White Hospital – College Station, a Texas nonprofit corporation, and Hillcrest Baptist Medical Center, a Texas nonprofit corporation (each, together with any successor corporation permitted under the Master Indenture or affiliate obligated under the Master Indenture hereafter, an “Obligated Affiliate”), Digital Assurance Certification, L.L.C. (the “Dissemination Agent”) in connection with the issuance by the Tarrant County Cultural Education Facilities Finance Corporation (the “Issuer”) of its Hospital Revenue Bonds (Baylor Scott & White Health Project) Series 2016A (the “Bonds”). The Bonds are being issued pursuant to an Indenture of Trust and Security Agreement, dated as of April 1, 2016 (the “Bond Indenture”), between the Issuer and The Bank of New York Mellon Trust Company, National Association, as bond trustee (the “Bond Trustee”). The Issuer has assigned to the Bond Trustee substantially all of the rights of the Issuer under that certain Loan Agreement, dated as of April 1, 2016 (the “Loan Agreement”), between the Issuer and the Corporation as security for the Bonds.

Section 1. Purpose of the Disclosure Agreement. This Disclosure Agreement is being executed and delivered by the Corporation, on behalf of the Obligated Affiliates, and the Dissemination Agent for the benefit of the Bondholders (including any beneficial owners thereof when the Bonds are held in a book-entry system) and in order to assist the Underwriters in complying with the Rule. The Corporation is an “obligated person” within the meaning of the Rule.

Section 2. Definitions. In addition to the definitions set forth in the Bond Indenture, which apply to any capitalized term used in this Disclosure Agreement unless otherwise defined in this Section 2, the following capitalized terms shall have the following meanings:

“*Annual Financial Information*” means, with respect to the prior fiscal year, the financial information, which shall be based on financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”), and operating data with respect to the Corporation of the general type included in the information set forth in APPENDIX A to the Official Statement, which shall include, among other things, the audited combined financial statements of Baylor Scott & White Health and information substantially consistent with the financial and operating data in APPENDIX A to the Official Statement under

the headings “OPERATING INFORMATION” and “FINANCIAL INFORMATION” (exclusive of proforma financial information).

“*Bondholder*” shall mean the registered owner of any Bond.

“*Combined Group Representative*” shall mean the Corporation, or any other entity appointed as such under the Master Indenture.

“*Disclosure Representative*” shall mean the Corporation, or such other person as the Combined Group Representative shall designate in writing to the Dissemination Agent in accordance with Section 6 hereof.

“*Dissemination Agent*” shall mean Digital Assurance Certification, L.L.C. and its successors and assigns, or any other Dissemination Agent designated as such in writing by the Disclosure Representative pursuant to the terms hereof. By execution hereof, the Disclosure Representative appoints Digital Assurance Certification, L.L.C. as Dissemination Agent and Digital Assurance Certification, L.L.C. accepts such appointment.

“*EMMA*” shall mean the Electronic Municipal Market Access system, operated by the MSRB and found at <http://www.emma.msrb.org>.

“*Listed Event*” means any of the following events with respect to the Bonds:

- (i) principal and interest payment delinquencies;
- (ii) non-payment-related defaults, if material;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701 TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds;
- (vii) modifications to rights of holders or beneficial owners, if material;
- (viii) Bond calls, if material;
- (ix) Bond defeasances;
- (x) release, substitution, or sale of property securing repayment of the Bonds, if material;
- (xi) rating changes;

(xii) tender offers;

(xiii) bankruptcy, insolvency, receivership or similar event of an Obligated Affiliate (an event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an Obligated Affiliate in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Obligated Affiliate, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of an Obligated Affiliate);

(xiv) consummation of a merger, consolidation, or acquisition involving an Obligated Affiliate or sale of all or substantially all of the assets of such Obligated Affiliate, other than in the ordinary course of business, or the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to the foregoing, other than pursuant to its terms, if material; and

(xv) appointment of a successor or additional trustee or the change of name of a trustee, if material.

“*Listed Event Notice*” means written or electronic notice of a Listed Event.

“*MSRB*” means the Municipal Securities Rulemaking Board. The current address of the MSRB is 1300 I Street, NW, Suite 1000, Washington, D.C. 20005-3314.

“*Official Statement*” means the Official Statement dated _____, 2016 delivered in connection with the issuance of the Bonds, as supplemented and amended.

“*Rule*” means Rule 15c2-12 adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“*Underwriters*” means Citigroup Global Markets Inc., J.P. Morgan Securities LLC, Estrada Hinojosa & Company, Inc. and Siebert Brandford Shank & Co., L.L.C. whether acting together or singly.

Section 3. Undertaking to Provide Ongoing Disclosure.

(a) This Disclosure Agreement constitutes the written undertaking of each Obligated Affiliate for the benefit of the Bondholders (including any beneficial owners thereof when the Bonds are held in a book-entry system). It is the express intention of each Obligated Affiliate that each Bondholder (including any beneficial owners thereof when the Bonds are held in a book-entry system) be a beneficiary of this Disclosure Agreement with the right to enforce this Section 3 directly against the Obligated Affiliates.

(b) Each Obligated Affiliate undertakes to provide the Annual Financial Information and the Listed Event Notices.

(c) The Obligated Affiliates, or the Disclosure Representative on behalf of the Obligated Affiliates, shall, while any Bonds are outstanding, provide Annual Financial Information to EMMA, not later than 180 days after the end of the Corporation's fiscal year (the "Report Date"). On or before the Report Date (the "Submission Date"), the Disclosure Representative shall submit the Annual Financial Information to the Dissemination Agent. The Disclosure Representative shall include with each submission of Annual Financial Information to the Dissemination Agent a written representation addressed to the Dissemination Agent to the effect that the Annual Financial Information is the Annual Financial Information required by this Section 3 and that it complies with the applicable requirements of this Section 3. The Disclosure Representative may adjust the Submission Date and the Report Date if the Corporation changes its fiscal year by providing written notice of the change of fiscal year and the new Submission Date and Report Date to the Dissemination Agent, if any, and EMMA; provided that the new Report Date shall be 180 days after the end of the new fiscal year and the new Submission Date shall be on or prior to the Report Date, and provided further that the period between the final Report Date relating to the former fiscal year and the initial Report Date relating to the new fiscal year shall not exceed one year in duration. It shall be sufficient if the Disclosure Representative provides EMMA the Annual Financial Information by specific reference to documents previously provided to EMMA, or filed with the Securities and Exchange Commission and, if such a document is a final official statement, available from the MSRB. The Dissemination Agent shall have no duty to review or analyze any financial statements delivered to it hereunder or verify the accuracy thereof and shall hold such financial statements solely as a repository for the benefit of the Bondholders; the Dissemination Agent shall not be deemed to have notice of any information contained therein or event of default which may be disclosed therein in any manner.

(d) If a Listed Event occurs while any Bonds are outstanding, the Disclosure Representative, on behalf of the Obligated Affiliates, shall provide a Listed Event Notice to the Dissemination Agent in a timely manner and not more than ten business days after the occurrence of such Listed Event and the Dissemination Agent shall then promptly distribute the Listed Event Notice to EMMA. Each Listed Event Notice shall be so captioned and shall prominently state the date, title and CUSIP numbers of the Bonds.

Upon receipt of a written request, the Disclosure Representative shall provide any Bondholder with a copy of the most recent Annual Financial Information and any Listed Event Notice filed with EMMA

(e) The Disclosure Representative shall provide notice in a timely manner to the Dissemination Agent and EMMA, of any failure while any Bonds are outstanding to provide Annual Financial Information on or before the Report Date (for any reason) as provided herein.

(f) The Disclosure Representative may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor

Dissemination Agent. If no Dissemination Agent has been appointed or engaged or if a Dissemination Agent resigns or is otherwise removed and no successor Dissemination Agent is appointed or engaged, the Disclosure Representative shall perform all of the duties and assume all of the obligations of the Dissemination Agent hereunder.

(g) If a Dissemination Agent has been designated, the Dissemination Agent shall:

(i) For the purposes of determining whether information received from the Disclosure Representative is Annual Financial Information, be entitled conclusively to rely on the Disclosure Representative's written representation made pursuant to subsection (c) hereof.

(ii) If the Disclosure Representative or the Bond Trustee provides to the Dissemination Agent information relating to the Obligated Affiliates or the Bonds, which information is not designated as a Listed Event Notice, and directs the Dissemination Agent in writing to provide such information to EMMA, provide such information in a timely manner to EMMA.

(iii) If by the Submission Date, the Dissemination Agent has not received a copy of the Annual Financial Information, contact the Disclosure Representative to determine if the Obligated Affiliates are in compliance with subsection (c).

(iv) If the Dissemination Agent has not itself provided or received the representation from the Disclosure Representative that it has provided the Annual Financial Information to EMMA by the Report Date (for any reason), send a notice to EMMA and the Disclosure Representative in substantially the form attached as Exhibit A; provided, however, this subsection (iv) shall not apply if EMMA shall mean the Corporation's website.

(v) File a report with the Disclosure Representative certifying that the Annual Financial Information and Listed Event Notices, as applicable, have been provided pursuant to this Disclosure Agreement, stating the date it was provided, and listing all the parties to which it was provided.

(h) In addition, each Obligated Affiliate covenants to provide to the Disclosure Representative and the Dissemination Agent, if any, Annual Financial Information and Listed Event Notices with respect to such Obligated Affiliate from time to time to the extent that such Obligated Affiliate continues to be bound hereby.

(i) Unless otherwise required by law and subject to technical and economic feasibility, the Disclosure Representative and the Dissemination Agent, if any, shall employ such methods of information transmission as shall be required or recommended by the designated recipients of the Obligated Affiliates' information.

(j) Any filing under this Disclosure Agreement may be made solely by transmitting such filing to the MSRB through EMMA, or as otherwise permitted hereunder or deemed reasonable by the Corporation in the event EMMA is not available for filing.

(k) The Obligated Affiliates hereby agree to provide “other financial information” relating to the Obligated Affiliates as supplementary unaudited information to their audited financial statements, which shall only require that a statement of operations and changes in net assets and balance sheet of the Obligated Affiliates be provided, if, and only if, the Obligated Affiliates shall choose pursuant to Section 1.06 of the Master Indenture to test their financial covenants based on the Combined Group Financial Statements. Information required under this Section 3(k) shall be filed concurrently with the Annual Financial Information required to be filed under Section 3(c).

Section 4. Obligated Persons.

(a) In the event that any other person subsequently desires to become an Obligated Affiliate, the Combined Group Representative shall require such person to enter into a written undertaking to comply with the provisions set forth in this Disclosure Agreement as a condition of such person becoming an Obligated Affiliate.

(b) Any Obligated Affiliate reserves the right to terminate its obligation to provide Annual Financial Information and notices of Listed Events, as set forth above, if and when such person is no longer an Obligated Affiliate or obligated to make payments on the Bonds. The Disclosure Representative will provide notice of any such termination to EMMA.

(c) If the Corporation’s obligations under the Loan Agreement are assumed in full by some other entity and the Corporation is no longer an Obligated Affiliate, such other entity shall be responsible for compliance with this Disclosure Agreement in the same manner as if it were the Corporation, and the Corporation shall have no further responsibility hereunder.

(d) By executing this Disclosure Agreement, the Disclosure Representative represents that it has the right, power and authority to and is agreeing for itself and each other Obligated Affiliate that each Obligated Affiliate is bound by the provisions of this Disclosure Agreement.

Section 5. Termination of Reporting Obligation. The continuing obligation of the Obligated Affiliates to provide Annual Financial Information and Listed Event Notices shall terminate immediately once the Bonds are no longer outstanding or may terminate in accordance with Section 7 hereof.

Section 6. Disclosure Representative. The Combined Group Representative shall, from time to time, appoint or engage a Disclosure Representative to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Disclosure Representative, upon appointment of a successor Disclosure Representative. If at any time there is not any other designated Disclosure Representative, the Corporation shall be the Disclosure Representative. The Combined Group Representative hereby appoints the Corporation as the initial Disclosure Representative and the Corporation hereby accepts such appointment.

Section 7. Amendment; Waiver. The provisions of this Disclosure Agreement, including but not limited to the information contained in the Annual Financial Information, may be amended from time to time as deemed appropriate by the Corporation on behalf of the Obligated Affiliates; provided, however, that after giving effect to any amendment, the Obligated

Affiliates shall still be obligated to provide information generally consistent with that described herein taking into account what is then reasonable and comparable for the Obligated Affiliates and generally customary in the presentation of such information by the healthcare industry. Amendments to this Disclosure Agreement may also include, but are not limited to, the provisions relating to the accounting principles pursuant to which the financial statements of the Corporation are prepared.

In the first Annual Financial Information to which an amendment changing the Annual Financial Information applies, the Annual Financial Information shall explain the reason for the amendment and the impact of the amendment on the type of operating data or financial information being provided, including a qualitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information. The Disclosure Representative shall provide notice of such amendment to EMMA.

Section 8. Additional Information. Nothing in this Disclosure Agreement shall be deemed to prevent the Obligated Affiliates from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Financial Information or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Agreement.

Section 9. Default. In the event of a failure of the Obligated Affiliates or the Disclosure Representative, on behalf of the Obligated Affiliates, to comply with any provision of this Disclosure Agreement, the Dissemination Agent may (and, at the request of the Underwriters or the Bondholders or beneficial owners of at least 25% aggregate principal amount of outstanding Bonds and upon being indemnified to its satisfaction, shall), or any Bondholder may take such actions as may be necessary and appropriate to seek specific performance by court order, to cause the Obligated Affiliates, or the Disclosure Representative, on behalf of the Obligated Affiliates, to comply with their obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Bond Indenture, the Loan Agreement or the Master Indenture, and the sole remedy under this Disclosure Agreement in the event of any failure of the Obligated Affiliates, or the Disclosure Representative, on behalf of the Obligated Affiliates to comply with this Disclosure Agreement shall be an action to compel performance.

Section 10. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Agreement and no implied covenants or obligations shall be read into this Disclosure Agreement against the Dissemination Agent, and the Obligated Affiliates agree to jointly and severally indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including reasonable attorneys' fees, costs and expenses) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the Obligated Affiliates under this Section 10 shall survive

resignation or removal of the Dissemination Agent and payment of the Bonds. In the absence of bad faith on its part, the Dissemination Agent may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished to the Dissemination Agent and conforming to the requirements of this Disclosure Agreement. In the case of any Annual Financial Information disclosure or any Listed Event disclosure, or any opinions which, by any provision hereof, are specifically required to be furnished to the Dissemination Agent, the Dissemination Agent shall be under a duty to examine the same to determine whether or not they conform to the requirements of this Disclosure Agreement, but shall be under no duty to verify independently or investigate the accuracy or completeness of any information contained therein or the correctness of any opinion furnished hereunder. No provision of this Disclosure Agreement shall require the Dissemination Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, provided that the Dissemination Agent shall pay such reasonable expenses, disbursements and advances necessary to perform its obligations hereunder, which expenses, disbursements and advances are expected to be reimbursed under Section 12 hereof.

Section 11. Beneficiaries. This Disclosure Agreement shall inure solely to the benefit of the Obligated Affiliates, the Dissemination Agent, the Underwriters, and the Bondholders (including any beneficial owners thereof when the Bonds are held in a book-entry system) from time to time of the Bonds, and shall create no rights in any other person or entity.

Section 12. Compensation. The Obligated Affiliates hereby jointly and severally agree to compensate the Dissemination Agent for the services provided and the expenses incurred pursuant to this Disclosure Agreement, in an amount to be agreed upon from time to time, and to reimburse the Dissemination Agent upon its request for all reasonable expenses, disbursements and advances incurred by the Dissemination Agent hereunder (including any reasonable compensation and cost and expenses of counsel) except any such expense, disbursement or advance that may be attributable to the Dissemination Agent's negligence or willful misconduct.

Section 13. Governing Law. This Disclosure Agreement shall be governed by and construed in accordance with the laws of the State of Texas without regard to conflict of law principles.

Section 14. Counterparts. This Disclosure Agreement may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

Date: April __, 2016

BAYLOR SCOTT & WHITE HOLDINGS,

By: BAYLOR SCOTT & WHITE HOLDINGS, as
Disclosure Representative, on behalf of itself and
the Obligated Affiliates

By: _____
Authorized Representative

DIGITAL ASSURANCE CERTIFICATION,
L.L.C.,
as Dissemination Agent

By: _____
Authorized Officer

Signature Page to Continuing Disclosure Agreement

EXHIBIT A

NOTICE OF FAILURE TO FILE ANNUAL FINANCIAL INFORMATION

Name of Bond Issue: Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds (Baylor Scott & White Health Project) Series 2016A

Name of Obligated Persons: Baylor Scott & White Holdings (“BSW Holdings”), Baylor Scott & White Health, a Texas nonprofit corporation, Baylor Health Care System, a Texas nonprofit corporation, Baylor University Medical Center, a Texas nonprofit corporation, Baylor All Saints Medical Center, a Texas nonprofit corporation, Baylor Regional Medical Center at Grapevine, a Texas nonprofit corporation, Baylor Medical Center at Waxahachie, a Texas nonprofit corporation, Baylor Regional Medical Center at Plano, a Texas nonprofit corporation, Baylor Medical Centers at Garland and McKinney, a Texas nonprofit corporation, Scott & White Healthcare, a Texas nonprofit corporation, Scott & White Memorial Hospital, a Texas nonprofit corporation, Scott & White Clinic, a Texas nonprofit corporation, Scott & White Hospital – Round Rock, a Texas nonprofit corporation, Scott & White Continuing Care Hospital, a Texas nonprofit corporation, Scott & White Hospital – College Station, a Texas nonprofit corporation, and Hillcrest Baptist Medical Center, a Texas nonprofit corporation.

NOTICE IS HEREBY GIVEN that the *[Insert name of applicable Obligated Person(s)]* has/have not provided an Annual Report with respect to the above-named Bonds as required by Section 3(c) of the Continuing Disclosure Agreement dated April __, 2016, among, the Obligated Persons listed above and Digital Assurance Certification, L.L.C., as dissemination agent. The *[Insert name of applicable Obligated Person(s)]* anticipate/s that the Annual Report will be filed by _____.

Dated: _____

cc: Disclosure Representative By: _____
[if notice is sent by Dissemination Agent.] Its: _____

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