CONSOLIDATED FINANCIAL STATEMENTS

Capital Health System, Inc. and Subsidiaries
Years Ended December 31, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP

Capital Health System, Inc. and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2018 and 2017

Contents

Building a better working world

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Report of Independent Auditors

The Board of Directors
Capital Health System, Inc.

We have audited the accompanying consolidated financial statements of Capital Health System, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 entity'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 financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Capital Health System, Inc. and Subsidiaries at December 31, 2018 and 2017, and the consolidated results of their operations, changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Adoption of ASU No. 2014-09, *Revenue from Contracts with Customers*, and ASU No. 2016-14, *Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities*

As discussed in Note 1 to the consolidated financial statements, Capital Health System, Inc. and Subsidiaries changed their method of revenue recognition as a result of the adoption of the amendments to the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) resulting from Accounting Standards Update No. (ASU) 2014-09, *Revenue from Contracts with Customers*, effective January 1, 2018, and adopted the amendments to the FASB ASC resulting from ASU 2016-14, *Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities*, effective December 31, 2018. Our opinion is not modified with respect to these matters.

Ernst & Young LLP

April 30, 2019

Capital Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2018	**2017**
Assets	*(In Thousands)*	
Current assets:		
Cash and cash equivalents	**$ 21,161**	$ 14,332
Short-term investments	**87,567**	94,890
Assets whose use is limited – current portion	**3,053**	3,141
Patient accounts receivable, net of allowance for uncollectibles of $10,858 in 2018 and $38,561 in 2017	**97,029**	88,933
Supplies	**9,119**	9,539
Prepaid expenses and other current assets	**20,496**	15,735
Total current assets	**238,425**	226,570
Investments	**6,542**	6,883
Assets whose use is limited – noncurrent portion	**128,746**	116,872
Property, plant, and equipment, net	**523,526**	556,723
Other noncurrent assets	**6,321**	6,756
	$ 903,560	$ 913,804
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	**$ 19,942**	$ 18,531
Accounts payable	**46,553**	33,748
Accrued expenses	**51,829**	46,876
Accrued interest	**3,827**	3,948
Estimated third-party payor settlements – current portion	**4,358**	5,363
Total current liabilities	**126,509**	108,466
Long-term debt, excluding current portion	**650,176**	669,153
Estimated third-party payor settlements and other long-term liabilities– noncurrent portion	**30,368**	27,395
Total liabilities	**807,053**	805,014
Commitments and contingencies		
Net assets:		
Without donor restrictions	**87,170**	99,772
With donor restrictions	**8,530**	8,394
Total Capital Health System net assets	**95,700**	108,166
Non-controlling interest	**807**	624
Total net assets including non-controlling interest	**96,507**	108,790
	$ 903,560	$ 913,804

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Consolidated Statements of Operations

	Year Ended December 31	
	2018	**2017**
Net assets without donor restrictions:	*(In Thousands)*	
Revenue:		
Net patient service revenue	**$ 654,428**	$ 646,936
Provision for bad debt	**–**	(50,023)
Net patient service revenue, less provision for bad debt	**654,428**	596,913
Other revenue	**13,187**	12,534
Contributions	**464**	354
Total revenue	**668,079**	609,801
Expenses:		
Salaries and wages	**311,202**	280,944
Employee benefits	**47,848**	45,195
Supplies and other expenses	**216,308**	202,553
Interest	**50,904**	52,307
Depreciation and amortization	**49,115**	49,285
Total expenses	**675,377**	630,284
Loss from operations prior to items below	**(7,298)**	(20,483)
Restructuring costs	**(674)**	–
Investment income and realized gains, net	**6,699**	7,320
Deficiency of revenue over expenses, before non-controlling interest	**(1,273)**	(13,163)
Less: gain attributable to non-controlling interest	**1,845**	1,694
Deficiency of revenue over expenses	**(3,118)**	(14,857)
Net change in unrealized gains and losses on investments	**(8,509)**	1,452
Net assets released from restrictions for equipment	**291**	491
Pension-related changes other than net periodic pension cost	**(1,266)**	3,765
Decrease in net assets without donor restrictions	**$ (12,602)**	$ (9,149)

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets

	Without Donor Restrictions	With Donor Restrictions	Non-controlling Interest	Total
	(In Thousands)			
Net assets at December 31, 2016	$ 108,921	$ 8,549	$ 660	$ 118,130
(Deficiency) excess of revenue over expenses	(14,857)	–	1,694	(13,163)
Net change in unrealized gains and losses on investments	1,452	–	–	1,452
Pension-related changes other than net periodic pension cost	3,765	–	–	3,765
Member distributions, net	–	–	(1,730)	(1,730)
Donor restricted contributions	–	651	–	651
Net assets released from restrictions for equipment	491	(491)	–	–
Net assets released from restrictions for operations	–	(315)	–	(315)
Decrease in net assets	(9,149)	(155)	(36)	(9,340)
Net assets at December 31, 2017	99,772	8,394	624	108,790
(Deficiency) excess of revenue over expenses	**(3,118)**	**–**	**1,845**	**(1,273)**
Net change in unrealized gains and losses on investments	**(8,509)**	**–**	**–**	**(8,509)**
Pension-related changes other than net periodic pension cost	**(1,266)**	**–**	**–**	**(1,266)**
Member distributions, net	**–**	**–**	**(1,662)**	**(1,662)**
Donor restricted contributions	**–**	**729**	**–**	**729**
Net assets released from restrictions for equipment	**291**	**(291)**	**–**	**–**
Net assets released from restrictions for operations	**–**	**(302)**	**–**	**(302)**
(Decrease) increase in net assets	**(12,602)**	**136**	**183**	**(12,283)**
Net assets at December 31, 2018	**$ 87,170**	**$ 8,530**	**$ 807**	**$ 96,507**

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2018	**2017**
	(In Thousands)	
Cash flows from operating activities		
Decrease in net assets	**$ (12,283)**	$ (9,340)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation and amortization	**49,115**	49,285
Amortization of deferred financing fees	**775**	795
Net change in unrealized gains and losses on investments	**8,509**	(1,452)
Loss (gain) on disposal of fixed assets	**671**	(1,853)
Pension-related changes other than net periodic pension cost	**1,266**	(3,765)
Member distributions, net, related to non-controlling interest	**1,662**	1,730
Changes in operating assets and liabilities:		
Patient accounts receivable, net	**(8,096)**	(2,814)
Supplies	**420**	(145)
Prepaid expenses and other current assets	**(4,761)**	549
Other noncurrent assets	**435**	1,151
Accounts payable	**12,805**	(970)
Accrued expenses	**3,687**	7,160
Accrued interest	**(121)**	(98)
Estimated third-party payor settlements and other long-term liabilities	**1,968**	(10,109)
Net cash provided by operating activities	**56,052**	30,124
Cash flows from investing activities		
Net purchases of assets whose use is limited	**(13,783)**	(9,316)
Net sales of investments	**1,153**	10,546
Distribution to Members	**(1,662)**	(1,730)
Cash proceeds from sale of property and equipment	**606**	1,915
Purchases of property and equipment, net	**(16,956)**	(12,250)
Net cash used in investing activities	**(30,642)**	(10,835)
Cash flows from financing activities		
Payments of capital leases	**(94)**	(10)
Payments of long-term debt	**(18,487)**	(17,256)
Net cash used in financing activities	**(18,581)**	(17,266)
Net increase in cash and cash equivalents	**6,829**	2,023
Cash and cash equivalents at beginning of year	**14,332**	12,309
Cash and cash equivalents at end of year	**$ 21,161**	$ 14,332
Noncash investing and financing transactions		
Assets acquired under capitalized lease obligations	**$ 240**	$ 217
Supplemental disclosures of cash flow information		
Cash paid for interest expense	**$ 50,250**	$ 51,610

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018
(Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies

Capital Health System, Inc. (Capital Health), a New Jersey nonprofit corporation, consists of two operating divisions: Capital Health Regional Medical Center (Regional) and Capital Health Medical Center – Hopewell (Hopewell). Regional is a separately licensed acute care hospital with 237 licensed beds, located in Trenton, New Jersey. Hopewell consists of a separately licensed acute care hospital with 221 licensed beds, located in Hopewell Township, New Jersey and an ambulatory care facility located in Hamilton, New Jersey. Capital Health is the sole member of Capital Health Foundation (the Foundation), a nonprofit corporation and Population Health Management Service LLC (PHM). Capital Health is also the sole shareholder of two for-profit corporations: Mercer Holding Corporation (Mercer Holding) and Capital Region Insurance Company (CRIC). Capital Health is the sole member of Capital Health Accountable Care Organization Limited Liability Company (ACO) and Capital Health Medical Group (CHMG), two limited liability companies with no activity in 2018 or 2017.

Effective January 24, 2017, Capital Health reorganized its corporate structure. Capital Healthcare, Inc. (CHI), a New Jersey nonprofit corporation, was formed as the sole member of Capital Health. CHI is also the sole member of Leading Integrated Network of Clinicians, LLC (LINC), a limited liability company with no activity in 2018 or 2017.

Mercer Holding owns 100% of the capital stock of Bellevue Avenue Management, Inc. (Bellevue), a for-profit company which provides management services; 100% of the capital stock of Oasis Spa at Hopewell, LLC (Oasis Spa), a for-profit company which provides spa services at Hopewell; and 100% of the capital stock of Capital Pharmacy LLC (Capital Pharmacy), a for-profit company with no activity in 2018 or 2017. On January 17, 2017, Mercer Holding formed Comprehensive Imaging and Diagnostics LLC (CI), a for-profit company which provides radiology services and owns 100% of the capital stock. Mercer Holding has a 42.5% ownership interest in Hamilton Surgery Center, LLC (Hamilton Surgery Center) and majority control of the Board of Directors. Mercer Holding accounts for the non-controlling interest in Hamilton Surgery Center in accordance with Accounting Standards Codification (ASC) 810, *Consolidation*.

1. Organization and Summary of Significant Accounting Policies (continued)

CRIC is a captive insurance company formed under the laws of the Cayman Islands, which provides professional and general liability coverage for Capital Health and its employees.

Capital Health System Condominium Association, Inc. (the Association) is a nonprofit corporation that provides maintenance, preservation and control of the common areas within Hopewell. Capital Health is grantor of the Association and has majority control of its Board of Trustees. As such, the Association is consolidated in the accompanying consolidated financial statements.

A summary of significant accounting policies of Capital Health follows:

Principles of Consolidation

The consolidated financial statements include the accounts of Capital Health, the Foundation, Mercer Holding, the Association, PHM, and CRIC. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, such as estimated allowance for uncollectible accounts, estimated settlements with third-party payors, professional liability insurance, pension benefit assets, and disclosures of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the amounts of revenue and expenses reported during the period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates and assumptions.

1. Organization and Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly-liquid instruments with a maturity of three months or less when purchased, excluding assets whose use is limited by board designation, debt and trust agreements or other arrangements and those held in the investment portfolio. Capital Health does not hold any money market funds with significant liquidity restrictions that would require the funds to be excluded from cash equivalents.

Patient Accounts Receivable and Net Patient Service Revenue

Patient accounts receivable for which Capital Health receives payment under prospective payment formulae, negotiated rates, or cost reimbursement, which cover the majority of patient services, are stated at the estimated net amount receivable from such payors, which are generally less than the established billing rates of Capital Health (see Note 3).

Prior to January 1, 2018, Capital Health provided an allowance for uncollectibles for estimated losses resulting from the unwillingness of patients to make payments for services. The allowance was determined by analyzing historical data and trends. Additions to the allowance for uncollectibles result from the provision for bad debts. Accounts receivable are charged off against the allowance for uncollectibles when management determines that recovery is unlikely and Capital Health ceases collection efforts. As described below, as a result of the adoption of Accounting Standards Update No. (ASU) 2014-09, beginning on January 1, 2018, the majority of the provision for bad debts as previously recorded is considered an implicit price concession and therefore, is shown as a direct reduction to net patient service revenue as opposed to as provision for bad debt. As such, beginning on January 1, 2018, additions to the allowance for uncollectibles result only from a delinquency of patient accounts that were considered collectible at the time patient care was provided.

Investments

Short-term investments are readily marketable and not subject to donor restriction. Investments include amounts under donor restrictions.

1. Organization and Summary of Significant Accounting Policies (continued)

Investments in equity securities (including mutual funds) with readily determinable fair values and all investments in debt securities (including mutual funds) are measured at fair value in the consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, other than temporary impairments of investments, and interest and dividends) are included in the deficiency of revenue over expenses, unless the income or loss is restricted by donor or law. Net change in unrealized gains and losses on investments, except for those unrealized losses which are deemed to be other than temporary impairments, are excluded from the deficiency of revenue over expenses. The fair value of marketable investments is determined by reference to quoted market prices.

Assets Whose Use is Limited

Assets whose use is limited includes investments held by CRIC (see Note 4), restricted investments for collateral, assets held under the debt agreement and assets held under a supplemental retirement plan. Assets whose use is limited are recorded at fair value determined by reference to quoted market prices.

Supplies

Supplies are carried at the lower of cost or net realizable value.

Deferred Financing Costs

Deferred financing costs include the costs of obtaining financing and are amortized over the period the obligation is outstanding using the effective interest method. Unamortized deferred financing costs of $8,554 and $9,329 at December 31, 2018 and 2017, respectively, has been reported as a direct reduction from long-term debt in the consolidated balance sheets. Deferred financing fees are reported net of accumulated amortization of $8,135 and $7,360 at December 31, 2018 and 2017, respectively.

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost, except those acquired by gift or bequest which are recorded at their fair value established at the date of contribution.

1. Organization and Summary of Significant Accounting Policies (continued)

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method. The estimated lives range from one to forty years.

Capital Health continually evaluates whether later events and circumstances have occurred that indicate that the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance may not be recoverable. When factors indicate that long-lived assets should be evaluated for possible impairment, Capital Health uses an estimate of the related undiscounted operating income over the remaining life of the long-lived asset, or determines the fair value of the long-lived asset in measuring whether the long-lived asset is recoverable.

Estimated Professional Liabilities

Insurance reserves represent estimated unpaid losses and loss adjustment expenses. Such amounts are established using management's estimates on the basis of claims records and an independent actuarial review and include an amount for the adverse development of reported claims. Adjustments to the estimate of the liability for losses are reflected in earnings in the period in which the adjustment is determined. The insurance reserves are based on estimates and, while management believes that the amount is adequate, the ultimate liability may vary significantly from the amount provided. Amounts are recorded within other long-term liabilities within the accompanying consolidated balance sheets.

Classification of Net Assets

Capital Health separately accounts for and reports net assets without donor restrictions and net assets with donor restrictions. Net assets without donor restrictions are not externally restricted for identified purposes by donors. Net assets without donor restrictions include resources that the governing board may use for any designated purpose and resources whose use is limited by agreement between Capital Health and an outside party other than the donor.

Net assets with donor restrictions are those whose use by Capital Health has been limited by donors to a specific time period or purpose or have been restricted by donors as permanent endowments to be maintained in perpetuity. When the donors' intentions are met or a time restriction expires for net assets limited by donors to a specific time period or purpose, the net assets are reclassified to net assets without donor restriction and reported on the consolidated

1. Organization and Summary of Significant Accounting Policies (continued)

statements of operations as other revenue if intended for operations, or below deficiency of revenue over expenses, if intended for capital purposes, and on the consolidated statements of changes in net assets as net assets released from restrictions. Income earned from net assets with donor restrictions is included in investment income and realized gains, net, unless the income is restricted by the donor.

Capital Health follows the requirements of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as it relates to its net assets with donor restrictions to be maintained in perpetuity, as enacted by the State of New Jersey in 2009. Capital Health expends the income distributed from the related assets according to donor stipulations.

Advertising Costs

Capital Health expenses advertising costs as incurred. Total amounts charged to advertising expense during the years ended December 31, 2018 and 2017 are $4,005 and $2,653, respectively.

Deficiency of Revenue Over Expenses

The consolidated statements of operations include the deficiency of revenue over expenses as the performance indicator. Changes in net assets without donor restrictions which are excluded from the deficiency of revenue over expenses, include the net change in unrealized gains and losses on investments (excluding those considered to be other than temporary), net assets released from restrictions for equipment and pension-related changes other than net periodic pension cost.

Transactions deemed by management to be ongoing, major or central to the provision of health care services are reported within loss from operations.

1. Organization and Summary of Significant Accounting Policies (continued)

Income Taxes

Capital Health and the Foundation are nonprofit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Foundation is classified with public charity status of 170(b)(1)(A)(vi) under Section 501(c)(3) of the Code. These entities are also exempt from state and local income taxes. Mercer Holding is a taxable entity; amounts provided for federal and state and local income taxes are included in supplies and other expenses in the accompanying consolidated statements of operations. However, such amounts are not material for disclosure. The Association is a New Jersey nonprofit association, with no taxable income recorded during 2018 or 2017. CRIC is not subject to taxes on income or gains under Section 6 of the Cayman Islands Tax Concessions Law (Revised). Therefore, no provision for taxes has been made in the accompanying consolidated financial statements. ACO and Capital Pharmacy are taxable entities with no activity in 2018 or 2017. Therefore, no provision for taxes has been made in the accompanying consolidated financial statements.

The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017. For tax-exempt entities, TCJA requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income subject to tax, pay an excise tax on compensation above certain thresholds, and record income or losses for tax determination purposes from unrelated business activities on an activity-by-activity basis, among other provisions. Regulations necessary to implement certain aspects of TCJA are expected to be promulgated by the Internal Revenue Service (IRS) in 2019. As of and for the year ended December 31, 2018, Capital Health has made reasonable estimates of the provision for income taxes, the compensation excise tax, and the effects, if any, on existing deferred tax balances based on accounting guidance included in Accounting Standards Codification 740, *Income Taxes*. Capital Health will continue to refine its calculations in future periods as additional regulations and guidance are issued by the IRS.

Pension Plan

Capital Health's policy is to fund amounts as necessary on an actuarial basis to provide assets sufficient to meet the benefits to be paid to plan members in accordance with the requirements of the Employee Retirement Income Security Act of 1974 (ERISA).

1. Organization and Summary of Significant Accounting Policies (continued)

Capital Health recognizes in its consolidated balance sheets an asset for its defined benefit pension plan's (the Plan) overfunded status or a liability for the Plan's underfunded status, measures the Plan's assets and obligations that determine its funded status as of the end of its fiscal year, and recognizes changes in the funded status of the Plan in changes in net assets without donor restrictions in the year in which the changes occur (see Note 9).

Recent Accounting Pronouncements:

Adopted in 2018

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The core principle of ASU 2014-09 is that 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 guidance in ASU 2014-09 supersedes the FASB's prior revenue recognition requirements and most industry-specific guidance. The provisions of ASU 2014-09 are effective for Capital Health for annual reporting periods beginning after December 15, 2018. However, Capital Health has elected to early adopt ASU 2014-09 effective January 1, 2018. Capital Health adopted ASU 2014-09 following the modified retrospective method. As a result of implementing ASU 2014-09, certain patient activity where collection is uncertain (representing approximately $58,203 for the year ended December 31, 2018) previously reported through December 31, 2017 as net patient service revenue and the provision for bad debts in Capital Health's consolidated statements of operations no longer meets the criteria for revenue recognition and, accordingly, the provision for bad debts after the adoption date is significantly reduced with a corresponding reduction to net patient service revenue. Such patient activity is now classified as an implicit price concession. Additionally, the provision for bad debts, when applicable, will now be presented as an expense item rather than a reduction to net patient service revenue. Other aspects of Capital Health's implementation of ASU 2014-09 impacting net patient service revenue, which include judgements regarding collection analyses and estimates of variable consideration and the addition of certain qualitative and quantitative disclosures, are included in Note 3. The adoption of ASU 2014-09 in relation to other applicable revenue activity did not have a material impact to Capital Health's accompanying consolidated financial statements.

1. Organization and Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities*, which eliminates the requirement for not-for-profits (NFPs) to classify net assets as unrestricted, temporarily restricted and permanently restricted. Instead, NFPs are required to classify net assets as net assets with donor restrictions or without donor restrictions. The guidance also modified required disclosures and reporting related to net assets, investment expenses and information regarding liquidity. NFPs are also required to report all expenses by both functional and natural classification in one location. The provisions of ASU 2016-14 became effective for Capital Health for annual periods beginning after December 15, 2017. As such, Capital Health adopted ASU 2016-14 in its December 31, 2018 consolidated financial statements. The effects of the adoption of ASU 2016-14 were applied retrospectively, except for the disclosure of expenses by both natural and functional classification and the disclosures about liquidity and availability of resources, as permitted by ASU 2016-14.

Future Period Adoption

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 will require business-oriented health care not-for-profit entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in the performance indicator unless the investments qualify for a new practicality exception. The practicality exception is available for equity investments without a readily determinable fair value, for which measurement would be based on cost less impairment and adjusted for observable price changes. Subsequent to the adoption of ASU 2016-01, Capital Health will no longer be able to recognize unrealized holding gains and losses on equity securities currently classified as other-than-trading outside of the performance indicator. This ASU does not impact the accounting for investments in debt securities. ASU 2016-01 contains an additional provision that eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for Capital Health. The amendments of this ASU are applicable for fiscal years beginning after December 15, 2018, however, early adoption is permitted for the provision relating to the elimination of the requirement to disclose the fair value of financial instruments measured at amortized cost. As such, management has elected to early adopt this provision in 2018 and will no longer disclose the fair value of debt within its financial statements. The impact of fully adopting ASU 2016-01 will result in the inclusion of unrealized gains and losses on equity securities being reported within the performance indicator in the consolidated statements of operations.

1. Organization and Summary of Significant Accounting Policies (continued)

In February 2016, the FASB issued ASU 2016-02, *Leases* which will require lessees to report most leases on their balance sheets and recognize expenses on their income statement in a manner similar to current accounting. The guidance also eliminates current real estate-specific provisions. Lessors in operating leases continue to recognize the underlying asset and recognize lease income on either a straight-line basis or another systematic and rational basis. The provisions of ASU 2016-02 are effective for Capital Health for annual periods beginning after December 15, 2019, and interim periods within the period. Early adoption is permitted. Capital Health is in the process of evaluating the impact of ASU 2016-02 on its consolidated financial statements. Assets and liabilities are expected to increase to reflect Capital Health's right to use certain assets and the corresponding liabilities associated with operating leases, with no significant impact to net assets or the performance indicator.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments*, which addresses the following eight specific cash flow issues in order to limit diversity in practice: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The provisions of ASU 2016-15 are effective for Capital Health for annual periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is permitted. Capital Health is in the process of evaluating the impact of ASU 2016-15 on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows – Restricted Cash*, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of- period and end-of-period total amounts shown on the statement of cash flows. The provisions of ASU 2016-18 are effective for Capital Health for annual periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is permitted. Capital Health is in the process of evaluating the impact of ASU 2016-18 on its consolidated financial statements.

(Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958); Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made.* ASU 2018-08 clarifies existing guidance in order to address diversity in practice in classifying grants (including governmental grants) and contracts received by not-for-profit entities, and requires entities to evaluate whether the resource provider receives commensurate value. In addition, the standard clarifies the guidance on how entities determine when a contribution is conditional, including whether the agreement includes a barrier (or barriers) that must be overcome for the recipient to be entitled to the transferred assets and a right of return of the transferred assets (or a right of release of the promisor's obligation to transfer the assets). The standard should be applied on a modified prospective basis to agreements that are not completed as of the effective date and to agreements entered into after the effective date. Retrospective application is permitted. ASU 2018-08 applies to all entities that make or receive contributions and is effective for Capital Health for fiscal years beginning after June 15, 2018, including interim periods within those years. Early adoption is permitted. Capital Health is in the process of evaluating the impact of ASU 2018-08 on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*. The standard aligns the requirement for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this standard. The standard requires the customer in a hosting arrangement that is a service contract to follow the guidance in ASC Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense by determining which project stage an implementation activity relates to and the nature of the costs. The standard also requires the customer to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. ASU 2018-15 is effective for Capital Health for fiscal years beginning after December 15, 2020, and interim periods thereafter. Early adoption is permitted, including adoption in any interim period. Either retrospective or prospective adoption is permitted. Capital Health is in the process of evaluating the impact of ASU 2018-15 on its consolidated financial statements.

1. Organization and Summary of Significant Accounting Policies (continued)

The FASB has amended certain guidance related to various disclosures in ASU No. 2018-09, *Codification Improvements*, ASU No. 2018-13, *Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10)—Recognition and Measurement of Financial Assets and Financial Liabilities*, and ASU No. 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20)—Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*. Among various provisions, ASU No. 2018-09 may result in additional assets included in an entity's fair value disclosure table if, among other criteria, net asset value has public visibility. ASU No. 2018-13 includes several disclosure changes involving transfers between the fair value levels and other updates related to fair value level 3 investments. ASU No. 2018-13 also requires entities that use the practical expedient to measure the fair value of certain investments at their net asset values to disclose (1) the timing of liquidation of an investee's assets and (2) the date when redemption restrictions will lapse, but only if the investee has communicated this information to the entity or announced it publicly. The guidance in ASU No. 2018-14 requires all sponsors of defined benefit plans to provide certain new disclosures: the weighted-average interest crediting rate for cash balance plans and other plans with promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. Among other changes, ASU No. 2018-14 eliminates the required disclosure for all sponsors of defined benefit plans to disclose the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year. The updates noted above have effective dates as follows with early adoption permitted: ASU No. 2018-09: fiscal years beginning after December 15, 2018; ASU No. 2018-13: fiscal years beginning after December 15, 2019; and ASU No. 2018-14: fiscal years ending after December 15, 2021. Capital Health is in the process of evaluating the impact of these ASUs on its consolidated financial statements.

2. Charity Care

Capital Health provides care to patients who meet certain criteria defined by the New Jersey Department of Health (DOH) without charge or at amounts less than established rates. Because Capital Health does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Capital Health's records identify and monitor the level of charity care it provides and include the amount of charges forgone for services and supplies furnished. DOH allows retroactive application for charity care up to two years from the date of service.

2. Charity Care (continued)

The costs of charity care is derived from both estimated and actual data. The estimated cost of charity care includes the direct and indirect cost of providing such services and is estimated utilizing Capital Health's ratio of cost to gross charges, which is then multiplied by the gross uncompensated charges associated with providing care to charity patients. Charity care provided, at cost, during 2018 and 2017 totaled approximately $31,714 and $32,348, respectively.

Capital Health receives payments from the New Jersey Health Care Subsidy Funds for charity care and such amounts totaled approximately $15,575 and $16,435 for the years ended December 31, 2018 and 2017, respectively (Note 3).

3. Net Patient Service Revenue

Patient Accounts Receivable and Net Patient Service Revenue

For Periods Commencing January 1, 2018

Effective January 1, 2018 upon the adoption of ASU 2014-09, net patient service revenue is reported at the amount that reflects the consideration to which Capital Health expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration (reductions to revenue) in determining a transaction price.

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

Capital Health's initial estimate of the transaction price for services provided to patients subject to revenue recognition is determined by reducing the total standard charges related to the patient services provided by various elements of variable consideration, including contractual adjustments, discounts, implicit price concessions, and other reductions to Capital Health's standard charges. Capital Health determines the transaction price associated with services provided

3. Net Patient Service Revenue (continued)

to patients who have third-party payor coverage on the basis of contractual or formula-driven rates for the services rendered (see description of third-party payor payment programs below). The estimates for contractual allowances and discounts are based on contractual agreements, Capital Health's discount policies and historical experience. For uninsured and under-insured patients who do not qualify for charity care, Capital Health determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on Capital Health's historical collection experience for applicable patient portfolios. Under Capital Health's hospital collections and financial assistance policy, a patient who has no insurance or is under-insured and is ineligible for any government assistance program has his or her bill reduced to (1) the lesser of amounts generally billed or (2) 115% of the Medicare diagnostic-related group for inpatient or 115% of the Medicare fee-for-service rates for outpatient. Patients who meet the Hospital's criteria for free care are provided care without charge; such amounts are not reported as revenue.

Generally, Capital Health bills patients and third-party payors several days after the services are performed and/or the patient is discharged. Net patient service revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by Capital Health. Net patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total charges. Capital Health believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the services needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services or patients receiving services in Capital Health's outpatient and ambulatory care facilities. Capital Health measures the performance obligation from admission into the hospital or the commencement of an outpatient service to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or the completion of the outpatient visit.

As substantially all of its performance obligations relate to contracts with a duration of less than one year, Capital Health has elected to apply the optional exemption provided in ASU 2014-09 and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period for patients who

3. Net Patient Service Revenue (continued)

remain admitted at that time (in-house patients). The performance obligations for in-house patients are generally completed when the patients are discharged, which for the majority of Capital Health's in-house patients occurs within days or weeks after the end of the reporting period.

Subsequent changes to the estimate of the transaction price (determined on a portfolio basis when applicable) are generally recorded as adjustments to patient service revenue in the period of the change. Portfolio collection estimates are updated quarterly based on collection trends. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay (determined on a portfolio basis when applicable) are recorded as bad debt expense. Bad debt expense for the year ended December 31, 2018 was not significant.

Capital Health has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the following factors: payors, lines of business and timing of when revenue is recognized. Tables providing details of these factors are presented below.

Net patient service revenue for the year ended December 31, 2018, recognized in the period from these major payor sources, based on primary insurance designation is as follows:

Medicare and Medicaid	$ 123,723
Managed Medicare and Managed Medicaid and Commercial	498,784
Subsidies, Self-pay, and Other	31,921
	$ 654,428

Deductibles, copayments and coinsurance under third-party payment programs which are the patient's responsibility are included within the payors categories above.

Net patient service revenue for the year ended December 31, 2018 by line of business is as follows (in thousands):

Hospital and Physician services	$ 640,801
Ambulatory services	13,627
	$ 654,428

3. Net Patient Service Revenue (continued)

Capital Health has elected the practical expedient allowed under ASU 2014-09 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to Capital Health's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less.

Settlements with third-party payors (see description of third-party payment programs below) for cost report filings and retroactive adjustments due to ongoing and future audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and Capital Health's historical settlement activity (for example, cost report final settlements or repayments related to recovery audits), including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Such estimates are determined through either a probability-weighted estimate or an estimate of the most likely amount, depending on the circumstances related to a given estimated settlement item. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price, were not significant for the year ending December 31, 2018.

For Periods Through December 31, 2017

Prior to the adoption of ASU 2014-09, Capital Health recognizes accounts receivable and patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered (see description of third-party payment programs below). For uninsured patients that do not qualify for charity care, Capital Health recognizes revenue on the basis of discounted rates under Capital Health's self-pay patient policy. Under the policy for self-pay patients, a patient who has no insurance and is ineligible for any government assistance program has his or her bill reduced to the amount which would be billed to a commercially insured patient.

(Dollars In Thousands)

3. Net Patient Service Revenue (continued)

Patient service revenue for the years ended December 31, 2017, net of contractual allowances and discounts (but before the provision for bad debt), recognized in the period from these major payor sources, is as follows:

	2017
Third party payors	$ 621,059
Self-pay	25,877
Total payors	$ 646,936

Deductibles and copayments under third-party payment programs with third-party payors are the patient's responsibility and Capital Health considers these amounts in its determination of the provision for bad debt based on collection experience. Accounts receivable are also reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, Capital Health analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debt. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, Capital Health analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debt, if necessary (for example, for payors who are known to have financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients, which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, Capital Health records a significant provision for bad debt in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between discounted rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

Capital Health's allowance for doubtful accounts totaled $38,561 at December 31, 2017 (of which $10,858 remains at December 31, 2018) related to services performed through December 31, 2017. The allowance for doubtful accounts for self-pay patients was approximately 30% of self-pay accounts receivable as of December 31, 2017. Overall, the total of self-pay discounts and write-

3. Net Patient Service Revenue (continued)

offs did not changed significantly for the year ended December 31, 2017. Capital Health did not experienced significant changes in write-off trends and has not changed its charity care policy for the year ended December 31, 2017.

Third-Party Payment Programs

Capital Health has agreements with third-party payors that provide for payment for services rendered at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare: Hospitals are paid for most Medicare inpatient and outpatient services under the national prospective payment system and other methodologies of the Medicare program for certain other services. Federal regulations provide for certain adjustments to current and prior years' payment rates, based on industry-wide and hospital-specific data. Medicare cost reports of Capital Health have been audited and settled for years through 2014, except for 2008, as of December 31, 2018.

Medicaid: Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under cost-based and fee schedule methodologies. Capital Health is reimbursed for outpatient services at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediary. The Medicaid cost reports of Capital Health for years through 2015 have been audited and settled as of December 31, 2018.

Other Third Party Payors: Capital Health also has entered into payment agreements with certain commercial insurance carriers and health maintenance organizations. The basis for payment to Capital Health under these agreements includes prospectively determined rates per discharge or days of hospitalization and discounts from established charges.

No material revenue was recorded in 2018 or 2017 for net adjustments and settlements related to prior years.

(Dollars In Thousands)

3. Net Patient Service Revenue (continued)

Capital Health has appealed certain items in audited cost reports. The outcome of these appeals is uncertain and, therefore, potential revenue associated with these appeals is not included within the accompanying consolidated statements of operations as the most likely amount or expected value could not be determined.

Revenue from the Medicare and Medicaid programs accounted for approximately 19% and 20% of Capital Health's net patient service revenue for the years ended December 31, 2018 and 2017, respectively.

There are various proposals at the federal and state levels that could, among other things, significantly reduce payment rates or modify payment methods. The ultimate outcome of these proposals and other market changes, including the potential effects of health care reform that has been enacted by the federal government, cannot presently be determined. Future changes in the Medicare and Medicaid programs and any reduction of funding could have an adverse impact on Capital Health.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Capital Health believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that could have a material adverse effect on its consolidated financial statements. Noncompliance with such laws and regulations could result in fines, penalties and exclusion from such programs.

Capital Health grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. Significant concentrations of patient accounts receivable at December 31, 2018 and 2017 are as follows:

	2018	2017
Medicare	**20%**	17%
Medicaid	**10**	6
Commercial carriers, including worker's compensation and auto	**68**	75
Self-pay patients	**2**	2
	100%	100%

(Dollars In Thousands)

3. Net Patient Service Revenue (continued)

State Subsidy Funds

The New Jersey Health Care Subsidy Funds were established for various purposes, including the distribution of charity care payments to hospitals statewide.

The following is a summary of subsidy revenue included in net patient service revenue:

	2018	2017
Charity care *(Note 2)*	**$ 15,575**	$ 16,435
Delivery system reform incentive payments	**3,561**	4,619
Mental health	**957**	958
	$ 20,093	$ 22,012

The Delivery System Reform Incentive Payment Pool (the Pool) is available to certain hospitals that are able to establish performance improvement activities in one of eight specified clinical improvement areas. Amounts received from the Pool are subject to the satisfaction of clinical improvement and the satisfaction of certain performance criteria. Any adjustments to the Pool allocations are processed prospectively.

Capital Health expects to receive approximately $8,599 in charity care subsidies for distributions scheduled through June 30, 2019. Charity care subsidies subsequent to June 30, 2019 are presently unknown.

(Dollars In Thousands)

4. Assets Whose Use is Limited

Assets whose use is limited consist of the following:

	December 31	
	2018	**2017**
Restricted investments for collateral	**$ 8,532**	$ 8,406
Assets held under supplemental retirement plan	**14,396**	13,125
Assets held under debt agreement	**96,723**	83,548
Assets held by CRIC *(see Note 12)*	**12,148**	14,934
Total assets whose use is limited	**131,799**	120,013
Less: assets whose use is limited – current portion	**3,053**	3,141
	$ 128,746	$ 116,872

Assets held under debt agreements are maintained for the following purposes:

	December 31	
	2018	**2017**
Mortgage reserve fund	**$ 93,670**	$ 80,407
Mortgage insurance premium	**3,053**	3,141
	$ 96,723	$ 83,548

(Dollars In Thousands)

4. Assets Whose Use is Limited (continued)

Capital Health's gross unrealized losses and fair value of individual securities, classified as assets whose use is limited, aggregated by investment category, which have been in a continuous unrealized loss position less than 12 months and greater than 12 months at December 31, 2018 and 2017 are as follows:

	December 31, 2018					
	Less than Twelve Months		Twelve Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed income securities (5 securities)	**$ 2,137**	**$ (135)**	**$ 6,991**	**$ (280)**	**$ 9,128**	**$ (415)**
Mutual funds – equity income securities (6 funds)	**7,660**	**(1,123)**	**646**	**(124)**	**8,306**	**(1,247)**
Total	**$ 9,797**	**$ (1,258)**	**$ 7,637**	**$ (404)**	**$ 17,434**	**$ (1,662)**

	December 31, 2017					
	Less than Twelve Months		Twelve Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed income securities (2 securities)	$ –	$ –	$ 3,466	$ (31)	$ 3,466	$ (31)
Mutual funds – equity income securities (2 funds)	–	–	934	(23)	934	(23)
Total	$ –	$ –	$ 4,400	$ (54)	$ 4,400	$ (54)

At December 31, 2018 and 2017, the unrealized losses of approximately $1,662 and $54, respectively, were not deemed to be other than temporary based on Capital Health's ability and intent to hold the funds until recovery.

(Dollars In Thousands)

5. Investments

Investments consist of the following:

	December 31	
	2018	**2017**
Cash and cash equivalents	**$ 2,582**	$ 3,564
Mutual funds – fixed income securities	**63,290**	68,080
Mutual funds – equity securities	**28,122**	29,929
Accrued interest	**115**	200
Total investments	**94,109**	101,773
Less short-term investments	**87,567**	94,890
	$ 6,542	$ 6,883

Investment income, included within investment income and realized gains, net, consists of the following:

	Year Ended December 31	
	2018	**2017**
Interest and dividend income	**$ 3,485**	$ 2,804
Net realized gains	**3,214**	4,516
Total investment income	**$ 6,699**	$ 7,320

(Dollars In Thousands)

5. Investments (continued)

At December 31, 2018 and 2017, unrealized losses of approximately $7,585 and $1,783, respectively, detailed below, were not deemed to be other than temporary based on Capital Health's ability and intent to hold the funds until recovery.

	December 31, 2018					
	Less than Twelve Months		Twelve Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds - equity securities (23 funds)	**$ 3,153**	**$ (486)**	**$ 23,499**	**$ (5,093)**	**$ 26,652**	**$ (5,579)**
Mutual funds - fixed income securities (45 funds)	**2,137**	**(86)**	**61,153**	**(1,920)**	**63,290**	**(2,006)**
Total	**$ 5,290**	**$ (572)**	**$ 84,652**	**$ (7,013)**	**$ 89,942**	**$ (7,585)**

	December 31, 2017					
	Less than Twelve Months		Twelve Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds - equity securities (2 funds)	$ –	$ –	$ 24,721	$ (973)	$ 24,721	$ (973)
Mutual funds - fixed income securities (35 funds)	–	–	66,439	(810)	66,439	(810)
Total	$ –	$ –	$ 91,160	$ (1,783)	$ 91,160	$ (1,783)

6. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level hierarchy for fair value measurements exists based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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

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

(Dollars In Thousands)

6. Fair Value Measurements (continued)

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

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

The following tables present the financial instruments carried at fair value by caption on the consolidated balance sheet based on the valuation hierarchy defined above:

	December 31, 2018			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Cash and cash equivalents	**$ 21,161**	**$ –**	**$ –**	**$ 21,161**
Assets whose use is limited:				
Assets held by CRIC *(see Note 12)*:				
Equity securities	**–**	**5,407**	**–**	**5,407**
Fixed income	**–**	**6,741**	**–**	**6,741**
Investments restricted for collateral:				
Mutual funds – fixed income securities	**8,532**	**–**	**–**	**8,532**
Assets held under supplemental retirement plan:				
Mutual funds – fixed income securities	**2,424**	**–**	**–**	**2,424**
Mutual funds – equity securities	**3,631**	**–**	**–**	**3,631**
Investment contract with insurance company	**–**	**8,341**	**–**	**8,341**
Assets held under debt agreement:				
Cash and cash equivalents	**5,871**	**–**	**–**	**5,871**
U.S. government securities	**–**	**90,852**	**–**	**90,852**
Total assets whose use is limited	**20,458**	**111,341**	**–**	**131,799**
Investments:				
Cash and cash equivalents	**2,582**	**–**	**–**	**2,582**
Mutual funds – fixed income securities	**63,405**	**–**	**–**	**63,405**
Mutual funds – equity securities	**28,122**	**–**	**–**	**28,122**
Total investments	**94,109**	**–**	**–**	**94,109**
Total assets at fair value	**$ 135,728**	**$ 111,341**	**$ –**	**$ 247,069**
Pension assets				
Mutual funds – fixed income securities	**$ 48,827**	**$ –**	**$ –**	**$ 48,827**
Mutual funds – equity securities	**10,946**	**–**	**–**	**10,946**
U.S. government securities	**–**	**12,591**	**–**	**12,591**
	$ 59,773	**$ 12,591**	**$ –**	**72,364**
Investments measured at net asset values:				
Equity alternatives				**426**
Total pension assets				**$ 72,790**

(Dollars In Thousands)

6. Fair Value Measurements (continued)

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 14,332	$ –	$ –	$ 14,332
Assets whose use is limited:				
Assets held by CRIC *(see Note 12)*:				
Equity securities	–	6,779	–	6,779
Fixed income	–	8,155	–	8,155
Investments restricted for collateral:				
Mutual funds – fixed income securities	8,406	–	–	8,406
Assets held under supplemental retirement plan:				
Mutual funds – fixed income securities	3,773	–	–	3,773
Mutual funds – equity securities	4,745	–	–	4,745
Investment contract with insurance company	–	4,607	–	4,607
Assets held under debt agreement:				
Cash and cash equivalents	6,156	–	–	6,156
U.S. government securities	–	77,392	–	77,392
Total assets whose use is limited	23,080	96,933	–	120,013
Investments:				
Cash and cash equivalents	3,564	–	–	3,564
Mutual funds – fixed income securities	68,280	–	–	68,280
Mutual funds – equity securities	29,929	–	–	29,929
Total investments	101,773	–	–	101,773
Total assets at fair value	$ 139,185	$ 96,933	$ –	$ 236,118
Pension assets				
Mutual funds – fixed income securities	$ 48,845	$ –	$ –	$ 48,845
Mutual funds – equity securities	15,505	–	–	15,505
U.S. government securities	–	11,460	–	11,460
	$ 64,350	$ 11,460	$ –	75,810
Investments measured at net asset values:				
Equity alternatives				4,165
Total pension assets				$ 79,975

Equity alternative financial instruments maintained by the Plan represent the Plan's investment in a hedge fund that is reported at fair value based upon net asset value as a practical expedient. Financial information used to evaluate the alternative investments is provided by the investment manager or general partner and includes fair value valuations (quoted market prices and values determined through other means) of underlying securities and other financial instruments held by the investee and estimates that require varying degrees of judgement. The alternative investments may indirectly expose the Plan to securities lending, short sales of securities, and trading in futures and forwards contracts, options, and other derivative products. Alternative investments often have liquidity restrictions under which capital may be divested only at specified times. At December 31, 2018 and 2017, there were no commitments or liquidity restrictions.

(Dollars In Thousands)

7. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	December 31	
	2018	**2017**
Land	**$ 48,694**	$ 48,660
Land improvements	**36,057**	35,902
Buildings, leasehold improvements and fixed equipment	**748,864**	747,178
Major movable equipment	**270,805**	261,215
	1,104,420	1,092,955
Accumulated depreciation and amortization	**(585,262)**	(538,797)
	519,158	554,158
Construction in progress	**4,368**	2,565
Property, plant, and equipment, net	**$ 523,526**	$ 556,723

Depreciation and amortization expense for the years ended December 31, 2018 and 2017 is $49,115 and $49,285, respectively.

Major moveable equipment includes assets held under capital lease obligations of $943 and $703 at December 31, 2018 and 2017, respectively, net of accumulated amortization of $568 and $492, respectively, as of those dates.

(Dollars In Thousands)

8. Long-Term Debt

Long-term debt consists of the following:

	December 31 2018	2017
FHA/GNMA Taxable Insured Mortgage Loan	**$ 678,308**	$ 696,795
Capital lease obligations of Mercer Holding with interest rates ranging from 4.3% to 6.0% payable monthly and quarterly	**364**	218
	678,672	697,013
Less unamortized deferred financing costs	**8,554**	9,329
Less current portion	**19,942**	18,531
	$ 650,176	$ 669,153

On April 7, 2009, Capital Health closed on a $755,875 mortgage insured by HUD through the Federal Housing Administration's (FHA's) Section 242 Hospital Mortgage Insurance Program.

The interest rate on the mortgage is 6.80% through July 31, 2018 and 6.77% from August 1, 2018 through December 31, 2020. On April 10, 2018, Capital Health closed on a debt modification which reduced the interest rate on the mortgage loan commencing January 1, 2021. Interest rates on the mortgage note were amended to 4.67% from January 1, 2021 through August 31, 2026 and 4.57% from September 1, 2026 through maturity date of January 1, 2037.

The following table outlines the principal and interest payments due and payable on the first day of each month for the entire loan's term:

September 1, 2018 – January 1, 2021	$ 5,428
February 1, 2021 – September 1, 2026	4,705
October 1, 2026 – January 1, 2037	4,682

The mortgage note is collateralized by a security interest and a mortgage on substantially all of the property, plant and equipment at the Regional and Hopewell divisions. Interest costs resulting from the portion of debt related to construction was capitalized accordingly.

(Dollars In Thousands)

8. Long-Term Debt (continued)

As of December 31, 2018 and 2017, Capital Health had an outstanding letter of credit totaling $1,390, related to an aspect of the Project. No amounts have been drawn at December 31, 2018 and 2017. The letter of credit expires in September 2019 and automatically renews for a term of one year.

Also in connection with the Project, Capital Health was required to provide a security interest in and lien on certain of its investments as collateral. As of December 31, 2018 and 2017, $8,532 and $8,406 of investments were pledged as collateral for the outstanding letters of credit. These investments are included in assets whose use is limited as of December 31, 2018 and 2017.

As of December 31, 2018 and 2017, Capital Health had outstanding letters of credit totaling $4,393 related to vendor arrangements. No amounts have been drawn on the letters of credit at December 31, 2018 and 2017. The letters of credit expire throughout 2019 and automatically renew for a term of one year.

Under the terms of the mortgage loan, Capital Health is required to maintain certain financial ratios, mortgage reserve fund balances, and comply with other restrictive covenants as described in the respective agreements in order to enter into additional indebtedness or to transfer funds to an affiliate without HUD approval. At December 31, 2018 and 2017 Capital Health was in compliance with the financial ratio requirements and mortgage reserve fund balance as described in the agreements.

Scheduled payments on long-term debt and capital lease obligations at December 31, 2018, net of interest, are as follows:

	FHA/ GNMA	Capital Lease	Total
2019	$ 19,822	$ 120	$ 19,942
2020	21,207	126	21,333
2021	26,866	74	26,940
2022	28,556	44	28,600
2023	29,920	–	29,920
Thereafter	551,937	–	551,937
Total long-term debt	$ 678,308	$ 364	$ 678,672

9. Retirement Plans

Capital Health has a non-contributory defined benefit pension plan and a defined contribution plan that operates under Section 403(b) of the Internal Revenue Code. Both plans cover substantially all of its employees. The benefits are based on years of service and compensation. Capital Health's funding policy provides that payments to the defined benefit pension plan shall be equal to the minimum funding requirement of ERISA plus additional amounts, which may be approved by Capital Health. In 2018 and 2017, Capital Health incurred $1,966 and $1,804, respectively, in pension expense for employer contributions to the defined contribution plan, which is included in employee benefits expense in the accompanying consolidated statements of operations.

As noted in Note 1, Capital Health recognizes in its consolidated balance sheets an asset, for the defined benefit plan's overfunded status, or a liability, for the plan's underfunded status; measures the defined benefit plan's assets and obligations that determine funded status as of the end of its fiscal year; and recognizes the periodic change in the funded status of the defined benefit plan as a component of changes in net assets without donor restrictions in the year in which the change occurs. Amounts that are recognized as a component of other changes in net assets without donor restrictions will be subsequently recognized as a component of net periodic pension cost.

Capital Health froze its defined benefit pension plan as of December 31, 2007.

Included in net assets without donor restrictions is unrecognized actuarial loss at December 31, 2018 and 2017 of $11,788 and $10,522, respectively, which has not yet been recognized in net periodic pension cost. At December 31, 2018 and 2017, Capital Health has a defined benefit asset of $4,176 and $5,543, respectively, which is reported within other noncurrent assets in the accompanying consolidated balance sheets.

The unrecognized actuarial loss included in net assets without donor restrictions at December 31, 2018 and expected to be recognized in net periodic pension cost during the year ending December 31, 2019 is approximately $312.

(Dollars In Thousands)

9. Retirement Plans (continued)

The following table sets forth the funded status of the plan at December 31, 2018 and 2017 and the amounts recognized in the consolidated financial statements:

	2018	2017
Change in benefit obligation		
Benefit obligation, beginning of year	**$ 74,432**	$ 77,158
Interest cost	**2,336**	2,655
Actuarial gain	**(2,791)**	(927)
Benefits paid	**(2,188)**	(4,454)
Settlements	**(3,175)**	–
Benefit obligation, end of year	**68,614**	74,432
Change in plan assets		
Fair value of plan assets, beginning of year	**79,975**	78,661
Actual return on plan assets	**(1,822)**	5,768
Benefits paid and settlements	**(5,363)**	(4,454)
Fair value of plan assets, end of year	**72,790**	79,975
Funded status	**$ 4,176**	$ 5,543

The net periodic pension cost (benefit) includes the following components:

	2018	2017
Interest cost	**$ 2,336**	$ 2,655
Expected return on plan assets	**(3,092)**	(3,555)
Recognized actuarial loss	**312**	626
Settlement loss	**545**	–
Periodic pension cost (benefit)	**$ 101**	$ (274)

The benefit obligations represent the projected and accumulated benefit obligation.

(Dollars In Thousands)

9. Retirement Plans (continued)

The following assumptions were used in determining the benefit obligations and net periodic pension cost:

	2018	2017
Weighted-average assumptions used to determine benefit obligations at December 31:		
Discount rate	**4.00%**	3.34%
Weighted-average assumptions used to determine net periodic pension cost for the years ended December 31:		
Discount rate	**3.34%**	3.69%
Expected long-term return on plan assets	**4.11%**	4.79%

The expected long-term rate of return on plan assets assumption of 4.11% was selected using the "building block" approach described by the Actuarial Standards Board in Actuarial Standards of Practice No. 27 – Selecting Economic Assumptions for Measuring Pension Obligations. Based on Capital Health's investment policy for the pension plan in effect as of the beginning of the fiscal year, a best estimate range was determined for both the real rate of return (net of inflation) and for inflation based on historical 30-year period rolling averages. An average inflation rate within the range equal to 4.0% was selected and added to the real rate of return range to arrive at a best estimate. The actuarial gains in 2018 and 2017 primarily relate to changes in discount rate and mortality assumptions used to measure the projected benefit obligation.

Capital Health's pension plan weighted-average asset allocations at December 31, 2018 and 2017 by asset category are as follows:

	Plan Assets at December 31	
	2018	2017
Mutual funds – equity securities	**15%**	20%
Mutual funds – fixed income securities	**67**	61
U.S. government securities	**17**	14
Other	**1**	5
	100%	100%

(Dollars In Thousands)

9. Retirement Plans (continued)

Capital Health expects to pay future benefits as follows:

2019	$ 7,072
2020	6,972
2021	6,338
2022	6,098
2023	5,303
2024-2028	22,699

Capital Health's investment policies and strategies for plan assets include allocations of a diversified portfolio of equity investments, fixed income securities and cash equivalents. Though these assets are long-term in nature, a reasonable amount of liquidity should be maintained.

Capital Health does not expect to contribute to its defined benefit pension plan in 2019.

10. Net Assets With Donor Restrictions

Net assets with donor restrictions are available for the following purposes:

	December 31	
	2018	**2017**
Health care services	**$ 2,912**	$ 2,651
Education	**643**	610
Equipment	**1,171**	1,355
Charity care	**3,628**	3,605
Other	**176**	173
	$ 8,530	$ 8,394

(Dollars In Thousands)

10. Net Assets With Donor Restrictions (continued)

Net assets were released from restrictions for the following purposes:

	Year Ended December 31	
	2018	**2017**
Equipment	**$ 291**	$ 491
Health care services	**254**	208
Education	**39**	52
Charity care	**4**	6
Other	**5**	49
	$ 593	$ 806

Changes in donor endowment funds for the years ended December 31, 2018 and 2017, consisted of the following:

	Without Donor Restrictions	**With Donor Restrictions**
Endowment funds at December 31, 2017	$ 1,935	$ 4,948
Investment return on endowments	**(350)**	**–**
Appropriations	**(4)**	**–**
Contributions	**–**	**13**
Endowment funds at December 31, 2018	**$ 1,581**	**$ 4,961**

	Without Donor Restrictions	**With Donor Restrictions**
Endowment funds at December 31, 2016	$ 1,127	$ 4,934
Investment return on endowments	822	–
Appropriations	(14)	–
Contributions	–	14
Endowment funds at December 31, 2017	$ 1,935	$ 4,948

(Dollars In Thousands)

10. Net Assets With Donor Restrictions (continued)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires Capital Health to retain as a fund of perpetual duration. Deficiencies of this nature are reported in net assets without donor restrictions. Individual donor-restricted endowment funds with deficiencies will retain future income and appreciation to restore the required fair value of the assets. There were no such deficiencies as of December 31, 2018 or 2017.

11. Operating Leases and Other Commitments and Contingencies

Rent expense under operating leases amounted to approximately $3,077 and $2,217 in 2018 and 2017, respectively, and is reported within supplies and other expenses on the accompanying consolidated statements of operations.

The future minimum rental payments required under the non-cancelable operating leases are as follows:

2019	$ 4,305
2020	4,844
2021	4,380
2022	3,727
2023	3,380
Thereafter	14,577

Various lawsuits and claims arising in the normal course of operations are pending or are in appeal against Capital Health. Such lawsuits and claims are either specifically covered by insurance or are not material. While the outcome of these lawsuits cannot be determined at this time, management believes that any loss which may arise from Capital Health's actions will not have a material adverse effect on the consolidated financial position or consolidated results of operations.

12. Professional Liability Insurance

Capital Health purchased first dollar claims made insurance coverage prior to April 5, 2003 through a commercial carrier. Under this program, the professional and general liabilities were insured under two policies. A "package policy" covered those risks related to Capital Health's general and professional liability as well as certain employed physicians. A "master physician policy" covered all other physicians for whom Capital Health provided coverage. The master physician policy also included an automatic tail provision. In addition to the two primary policies mentioned above, Capital Health purchased umbrella and excess insurance on a claims-made basis.

As of April 5, 2003, Capital Health purchases coverage for its professional and general liability exposures through CRIC. The reinsurance purchased by CRIC covers, on a claims-made basis, any incidents reported during the policy period for incidents from the retroactive date of August 10, 1976 to the end of the policy period.

For the period covering January 1, 2017 to April 30, 2017 CRIC insures Capital Health for its professional liability in the amount of $52,000 per claim and $56,000 in the annual aggregate. CRIC retains professional liability losses of $2,000 per claim and $6,000 in the annual aggregate (aggregate is shared with general liability). CRIC, therefore, cedes $50,000 per claim and $50,000 in the annual aggregate to "A" rated reinsurers. During the same insurance coverage period, CRIC insures Capital Health for its general liability in the amount of $51,000 per claim and $56,000 in the annual aggregate, of which $50,000 per claim and $50,000 in the annual aggregate is ceded to "A" rated reinsurers. CRIC, therefore, retains general liability losses of $1,000 per claim and $6,000 in the annual aggregate (aggregate is shared with professional liability).

For the period covering May 1, 2017 to April 30, 2018 CRIC insures Capital Health for its professional liability in the amount of $52,000 per claim and $58,000 in the annual aggregate. CRIC retains professional liability losses of $2,000 per claim and $8,000 in the annual aggregate (aggregate is shared with general liability). CRIC, therefore, cedes $50,000 per claim and $50,000 in the annual aggregate to "A" rated reinsurers. During the same insurance coverage period, CRIC insures Capital Health for its general liability in the amount of $51,000 per claim and $58,000 in the annual aggregate, of which $50,000 per claim and $50,000 in the annual aggregate is ceded to "A" rated reinsurers. CRIC, therefore, retains general liability losses of $1,000 per claim and $8,000 in the annual aggregate (aggregate is shared with professional liability).

12. Professional Liability Insurance (continued)

For the period covering May 1, 2018 to December 31, 2018 CRIC insures Capital Health for its professional liability in the amount of $62,000 per claim and $68,000 in the annual aggregate. CRIC retains professional liability losses of $2,000 per claim and $8,000 in the annual aggregate (aggregate is shared with general liability). CRIC, therefore, cedes $60,000 per claim and $60,000 in the annual aggregate to "A" rated reinsurers. During the same insurance coverage period, CRIC insures Capital Health for its general liability in the amount of $61,000 per claim and $68,000 in the annual aggregate, of which $60,000 per claim and $60,000 in the annual aggregate is ceded to "A" rated reinsurers. CRIC, therefore, retains general liability losses of $1,000 per claim and $8,000 in the annual aggregate (aggregate is shared with professional liability).

At December 31, 2018 and 2017, CRIC has recorded an estimated reserve for claims of $13,038 and $10,215, respectively, included in other long-term liabilities within the accompanying consolidated balance sheets, which includes an estimate for claims incurred but not reported. These undiscounted reserves are not offset by estimates of reinsurance claims. Estimated receivables for reinsurance recoveries recorded by CRIC of $1,927 and $1,196 at December 31, 2018 and 2017, respectively, are included in other noncurrent assets within the accompanying consolidated balance sheets.

Liabilities arising from incidents which occurred prior to April 5, 2003 which were known to Capital Health are the responsibility of Capital Health. No estimates were required as of December 31, 2018 and 2017.

(Dollars In Thousands)

13. Functional Expenses

Capital Health provides health care services to residents within its geographic region. Expenses related to providing these services were as follows:

	Year Ended December 31, 2018		
	Program Expenses	**General and Administrative Expenses**	**Total**
Salaries and wages	**$ 229,497**	**$ 81,705**	**$ 311,202**
Employee benefits	**35,240**	**12,608**	**47,848**
Supplies and other expenses	**156,288**	**60,020**	**216,308**
Interest	**45,204**	**5,700**	**50,904**
Depreciation and amortization	**41,185**	**7,930**	**49,115**
	$ 507,414	**$ 167,963**	**$ 675,377**

	Year Ended December 31, 2017
Program expenses	$ 473,179
General and administrative expenses	157,105
	$ 630,284

(Dollars In Thousands)

14. Liquidity and Availability

Financial assets available for general expenditures within one year of December 31, 2018, consist of the following:

Cash and cash equivalents	$ 21,161
Short-term investments	87,567
Patient accounts receivable, net	97,029
	$ 205,757

Capital Health has assets whose use is limited for collateral, held under supplemental retirement plan, held under debt agreement and held by CRIC. These assets whose use is limited, which are more fully described in Note 4, are not available for general expenditures within the next year and are not reflected in the amounts above.

As part of Capital Health's liquidity management plan, cash in excess of daily requirements are invested in cash equivalents and short-term investments.

15. Subsequent Events

Capital Health's management has evaluated subsequent events from December 31, 2018 through April 30, 2019, which is the date the consolidated financial statements were issued. There were no events identified that required adjustments to or disclosure in these consolidated financial statements.

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