AHS Hospital Corp.

Consolidated Financial Statements
December 31, 2016 and 2015

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Report of Independent Auditors

To the Board of Trustees of
AHS Hospital Corp.

We have audited the accompanying consolidated financial statements of AHS Hospital Corp. and its subsidiary, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, of changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of AHS Hospital Corp. and its subsidiary as of December 31, 2016 and 2015, and the results of their operations, changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

April 13, 2017
Florham Park, New Jersey

AHS Hospital Corp.
Consolidated Balance Sheets
December 31, 2016 and 2015

(in thousands)	2016	2015
Assets		
Current assets		
Cash and cash equivalents	$ 312,198	$ 209,482
Assets limited as to use	35,309	41,655
Patient accounts receivable, less allowance for doubtful accounts of $80,457 and $75,018 in 2016 and 2015, respectively	268,826	245,307
Other current assets	121,121	127,572
Total current assets	737,454	624,016
Assets limited as to use, net of current portion	912,547	856,739
Long-term investments and other assets	170,154	151,259
Property, plant and equipment, net	1,044,255	993,121
Total assets	$ 2,864,410	$ 2,625,135
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt	$ 8,447	$ 10,501
Accounts payable and accrued expenses	262,053	192,423
Estimated amounts due to third party payers	63,398	66,540
Total current liabilities	333,898	269,464
Accrued employee benefits and other, net of current portion	368,903	336,736
Long-term debt, net of unamortized bond premium (discount), debt issuance costs, and current portion	679,000	671,013
Total liabilities	1,381,801	1,277,213
Net assets		
Unrestricted	1,347,193	1,220,432
Temporarily restricted	85,388	78,532
Permanently restricted	50,028	48,958
Total net assets	1,482,609	1,347,922
Total liabilities and net assets	$ 2,864,410	$ 2,625,135

The accompanying notes are an integral part of these consolidated financial statements.

AHS Hospital Corp.
Consolidated Statements of Operations
Years Ended December 31, 2016 and 2015

(in thousands)	2016	2015
Unrestricted revenues, gains and other support		
Net patient service revenue (net of contractual allowances and discounts)	$ 2,250,165	$ 2,078,624
Provision for bad debts (net of recoveries)	(74,446)	(84,482)
Net patient service revenue less provision for bad debts	2,175,719	1,994,142
Other revenue	272,164	227,979
Net assets released from restrictions	18,321	18,202
Total revenues, gains and other support	2,466,204	2,240,323
Expenses		
Salaries	1,009,109	929,596
Supplies and other expenses	982,921	887,585
Employee benefits	206,244	187,331
Depreciation and amortization	127,471	120,613
Interest	28,040	22,129
Total operating expenses	2,353,785	2,147,254
Operating income	112,419	93,069
Nonoperating gains, net	33,785	33,513
Loss on defeasance	(33,482)	-
Excess of revenues over expenses	112,722	126,582
Other changes in unrestricted net assets		
Change in net unrealized gains (losses) on other than trading securities	39,295	(42,583)
Net assets released from capital restrictions	10,064	13,340
Government grants used for capital purchases	283	71
Change in funded status of benefit plans	(35,603)	(29,804)
Increase in unrestricted net assets	$ 126,761	$ 67,606

The accompanying notes are an integral part of these consolidated financial statements.

AHS Hospital Corp.
Consolidated Statements of Changes in Net Assets
Years Ended December 31, 2016 and 2015

(in thousands)	2016	2015
Unrestricted net assets		
Excess of revenues over expenses	$ 112,722	$ 126,582
Change in net unrealized gains (losses) on other than trading securities	39,295	(42,583)
Net assets released from capital restrictions	10,064	13,340
Government grants used for capital purchases	283	71
Change in funded status of benefit plans	(35,603)	(29,804)
Increase in unrestricted net assets	126,761	67,606
Temporarily restricted net assets		
Contributions	31,332	31,441
Investment income	1,723	1,763
Change in net unrealized gains (losses) on other than trading securities	2,186	(2,444)
Net assets released from restrictions for operations	(18,321)	(18,202)
Net assets released from capital restrictions	(10,064)	(13,340)
Increase (decrease) in temporarily restricted net assets	6,856	(782)
Permanently restricted net assets		
Donations	810	805
Change in net unrealized gains (losses) on other than trading securities	260	(511)
Increase in permanently restricted net assets	1,070	294
Increase in net assets	134,687	67,118
Net assets		
Beginning of year	1,347,922	1,280,804
End of year	$ 1,482,609	$ 1,347,922

The accompanying notes are an integral part of these consolidated financial statements.

AHS Hospital Corp.
Consolidated Statements of Cash Flows
Years Ended December 31, 2016 and 2015

(in thousands)	2016	2015
Cash flows from operating activities		
Change in net assets	$ 134,687	$ 67,118
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Change in funded status of benefit plans	35,603	29,804
Provision for bad debts	74,446	84,482
Depreciation and amortization	127,471	120,613
Loss on debt refunding/redemption	33,482	-
Loss on disposal of property, plant and equipment	348	353
Net realized and unrealized (gains) losses on other than trading securities	(49,122)	44,927
Change in value of swap agreements	(130)	(570)
Amortization of debt issuance costs and bond premium/discounts	(199)	41
Contributions restricted for capital	(8,905)	(9,157)
Contributions restricted for permanent investments	(585)	(805)
Changes in assets and liabilities		
Net patient accounts receivable	(97,965)	(100,775)
Other assets	(58,907)	(60,213)
Accounts payable, accrued expenses, estimated amounts due to third party payers, other liabilities and employee benefits	84,347	(47,048)
Net cash provided by operating activities	274,571	128,770
Cash flows from investing activities		
Purchases of investments	(83,451)	(182,326)
Proceeds from sales of investments	82,035	8,432
Intercompany loan issued to AHSIC	-	(20,690)
Loan payments from AHSIC	20,069	621
Acquisition of Hackettstown Division	(47,000)	-
Additions to property, plant and equipment	(131,168)	(147,884)
Net cash used in investing activities	(159,515)	(341,847)
Cash flows from financing activities		
Principal payments on long-term debt	(10,552)	(10,097)
Advance refunding of a portion of the Series 2008A and 2011 Tax-exempt Bonds	(234,370)	-
Proceeds from the issuance of the Series 2015 Taxable Bonds	-	200,000
Proceeds from the issuance of the Series 2016 Tax-exempt Bonds	224,800	-
Cost of issuance	(1,782)	(595)
Contributions restricted for capital	8,759	13,415
Contributions restricted for permanent investments	805	1,105
Net cash (used in) provided by financing activities	(12,340)	203,828
Increase (decrease) in cash and cash equivalents	102,716	(9,249)
Cash and cash equivalents		
Beginning of year	209,482	218,731
End of year	$ 312,198	$ 209,482
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 32,278	$ 17,331
Change in accruals for acquisition of property, plant and equipment	(785)	8,460

The accompanying notes are an integral part of these consolidated financial statements.

(in thousands)

1. Organization

AHS Hospital Corp. and Subsidiary (the "Hospital") is a not-for-profit entity comprised of five hospitals, the Morristown Medical Center ("Morristown Division"), the Overlook Medical Center ("Overlook Division"), the Newton Medical Center ("Newton Division"), the Chilton Medical Center ("Chilton Division") and the Hackettstown Medical Center ("Hackettstown Division"). The Hospital is organized under the not-for-profit corporation law of the State of New Jersey and is exempt from Federal income tax under Section 501(c) (3) of the Internal Revenue Code. The Hospital provides regional health care services including a broad range of adult, pediatric, obstetrical/gynecological, psychiatric, oncology, intensive care, cardiac care and newborn acute care services to patients from the counties of Morris, Essex, Passaic, Sussex, Bergen, Hunterdon, Union, Warren and Somerset in New Jersey, Pike County in Pennsylvania and southern Orange County in New York. The Hospital is also a regional health trauma center that provides tri-state coverage and provides numerous outpatient ambulatory services, rehabilitation and skilled care and emergency care.

Effective April 1, 2016, the Hackettstown Division was acquired from Adventist Healthcare, Inc. ("Adventist"), with the Hospital being substituted as the sole corporate member of Hackettstown Community Hospital. The Hospital paid $47,000 to purchase the property, plant and equipment, along with minimal amounts of long-term investments, inventories, and assumed liabilities of the Hackettstown Division from Adventist. The change in control of the Hackettstown Division was accounted for by the Hospital as an acquisition under the Merger and Acquisition guidance for Not-for-Profit entities, as further discussed in Note 16.

Included in the Hospital is the Foundation for the Morristown Medical Center ("MMCF"), a not-for-profit fundraising organization which solicits funds in its general appeal to support the Morristown Division and the community as MMCF's Board may deem appropriate. The by-laws of MMCF were amended on September 20, 2007, to provide that funds received by MMCF after the date of the amendment may be used for the benefit of the Overlook Division of the Hospital upon approval of the Executive Committee of the Board of MMCF.

The Hospital is a wholly controlled subsidiary of Atlantic Health System, Inc. (the "Parent"), a not-for-profit organization. The Parent wholly owns the following for-profit entities; Atlantic Health Management Corp., a for-profit holding company, which owns AHS Investment Corporation and Subsidiaries ("AHSIC"), AHS Insurance Company, Ltd. (the "Captive"), a for-profit insurance company licensed under the provisions of the Cayman Islands Insurance Law, Primary Care Partners, LLC, a for-profit physician practice entity, and AHS ACO, LLC ("ACO"), a for-profit limited liability company established for the purpose of participating in the Medicare Shared Savings Program under the Patient Protection and Affordable and Accountable Care Act of 2010. AHSIC holds real estate interests and manages health care businesses including magnetic resonance imaging, durable medical equipment and home care services. The Captive's principal activity is to provide for professional and commercial general liability insurance to the Parent and its subsidiaries beginning January 1, 2002. In addition, the Parent wholly owns the following not-for-profit entities; Atlantic Ambulance, a not-for-profit company established to provide emergency an nonemergency medical transportation to the Parent and its subsidiaries, North Jersey Health Care Properties which owns commercial buildings, Prime Care, Inc. which provides various wellness, health education and other health services, Newton Medical Center Foundation, Inc.("NMCF") and the Chilton Medical Center Foundation, Inc. ("CMCF"), both not-for-profit fund raising organizations for the benefit of their respective Hospital Divisions.

(in thousands)

The Overlook Foundation ("OF") and the Foundation for the Hackettstown Medical Center ("HMCF") are not-for-profit fundraising organizations affiliated with the Overlook and Hackettstown Divisions, respectively, however, they are not controlled subsidiaries of the Parent or the Hospital.

On June 19, 2013, the Parent signed an Operating Agreement with Hunterdon Healthcare System to form a jointly-owned health care alliance, Midjersey Health Alliance, LLC ("MHA"). The purpose of the organization is to form a regional healthcare alliance to improve and enhance the scope, quality and cost-effectiveness of health care services in Hunterdon, Somerset, Mercer and Warren counties while developing sound economic and financial solutions to health care issues affecting all patients, providers and healthcare organizations and moving toward clinical integration. Each system will retain its independence, but will create clinical and economic efficiencies to reduce health care costs.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of its controlled subsidiary MMCF. All significant intercompany balances and transactions are eliminated in consolidation.

New Authoritative Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for fiscal years beginning after December 15, 2017. The Hospital is currently assessing the impact the adoption of this standard will have on their consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, which eliminate the requirement to disclose fair value of financial instruments at amortized cost for entities that are not public business entities. The amendments in this update are effective for fiscal years beginning after December 15, 2018; however, early adoption is permitted for the elimination of the fair value of financial instruments disclosure guidance in the General Subsection of Section 825-10-50 (Financial Instruments Disclosures). The Hospital elected to early adopt this provision of the standard in fiscal year 2016 and removed the fair value disclosures accordingly.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of leases with a term of twelve months or less) at the commencement date: (a) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (b) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. The guidance requires a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial

statements. The modified retrospective approach would not require any transition accounting for leases that expire before the earliest comparative period presented. A full retrospective transition approach is not permitted. This guidance will be effective for the Hospital beginning in fiscal year 2019. Early application is permitted. The Hospital is currently assessing the impact the adoption of this standard will have on their consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. This standard marks the completion of the first phase of a larger project aimed at improving not-for-profit financial reporting. Under the new guidance, the existing three categories of net assets will be replaced with a simplified model that combines temporarily restricted and permanently restricted net assets into a single category called “net assets with donor restrictions” and renames unrestricted net assets as “net assets without donor restrictions.” There will be new reporting requirements for expenses and additional disclosures to describe an organization’s liquidity. The standard is effective for fiscal years beginning after December 15, 2017. The Hospital is currently assessing the impact this standard will have on their consolidated financial statements.

The FASB issued ASU 2016-15, on August 26, 2016, and ASU 2016-18, on November 17, 2016. The new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. ASU 2016-15 includes guidance on eight specific cash flow issues in an effort to reduce diversity in practice in how certain transactions are classified within the statement of cash flows. ASU 2016-18 addresses the presentation, disclosure, and cash flow classification of restricted cash and 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. Entities would also be required to reconcile these amounts on the balance sheet to the statement of cash flows and disclose the nature of the restrictions. The guidance is effective for financial statements issued for fiscal years beginning after December 31, 2018. Early adoption is permitted for ASU 2016-15 provided that all of the amendments are adopted in the same period. Both ASUs require application using a retrospective transition method. The Hospital is currently assessing the impact the adoption of these standards will have on their consolidated financial statements.

On January 5, 2017, the FASB issued ASU 2017-01 that revises the definition of a business. The definition of a business affects many areas of accounting (e.g., acquisitions, disposals, goodwill impairment, consolidation). When substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets), the assets acquired would not represent a business. This introduces an initial required screen that, if met, eliminates the need for further assessment. To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present (including for early stage companies that have not generated outputs). To be a business without outputs, there will now need to be an organized workforce. This guidance will be effective for the Hospital beginning in fiscal year 2019. Early application is permitted. The Hospital is currently assessing the impact the adoption of this standard will have on their consolidated financial statements.

(in thousands)

Use of Estimates
The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to contractual allowances, provision for bad debts, third party payer settlements, self-insurance liabilities, investment valuation, accrued employee benefits and purchase accounting. Actual results may differ from those estimates.

Cash and Cash Equivalents
Cash and cash equivalents include highly liquid short term investments with original maturities of three months or less from the date of acquisition which are not included in assets limited as to use by board designation or under trust agreements or investments.

At December 31, 2016 and 2015, the Hospital had cash balances in a financial institution that exceeded federal depository insurance limits. Management believes that the credit risk related to these deposits is minimal.

Assets Limited as to Use and Investments
Assets limited as to use principally consist of cash and investments held by a trustee under the bond indenture agreement and funds set aside by the Board of Trustees over which the Board of Trustees retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Hospital have been classified as current in the consolidated balance sheets at December 31, 2016 and 2015.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Fair value is generally determined by sales prices or bid-and-asked quotations that are available on a securities exchange registered with the Securities and Exchange Commission or in the over-the-counter market. For investments in mutual funds, the fair value per share, or unit, is the value that is determined and published and the basis for current transactions. All investments recorded in the consolidated balance sheets are considered other than trading securities. Investment income or loss, including realized gains and losses on investments, interest and dividends, is included in other revenue or nonoperating gains unless the income or loss is restricted by donor or law. Unrealized gains and losses on other than trading securities are recorded as other changes in unrestricted net assets in the consolidated statements of operations.

Beneficial Interest in Perpetual Trusts
The Hospital has been designated the beneficiary under certain perpetual trusts. The Hospital recognizes contribution revenue at the time an irrevocable trust is created at the fair value of the trust's assets. The contribution revenue is classified as permanently restricted. The Hospital revalues its interest in the perpetual trusts annually and reports any gain or loss as a change to permanently restricted net assets. The underlying investments held in trust are held primarily in equity securities with readily determinable fair values. Income earned on the trust assets is included in nonoperating gains.

(in thousands)

Other Current Assets
Included within other current assets in the consolidated balance sheets are receivables derived from physician practice revenue, amounts due from related parties, prepaid expenses and inventory.

Inventories
Inventories, primarily supplies, are included in other current assets and are stated at the lower of cost or market using the first-in, first-out method.

Property, Plant and Equipment
Property, plant and equipment are stated at cost. The Hospital provides for depreciation of land improvements, buildings and improvements, and equipment on a straight-line basis over the asset's estimated useful life. Capitalized leases are recorded at their present value at the inception of the lease. Equipment under capital leases is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation expense in the consolidated financial statements. When assets are retired or otherwise disposed of, the cost and the related depreciation are reversed from the accounts, and any gain or loss is reflected in current operations. Repairs and maintenance expenditures are expensed as incurred.

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future net cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. For the years ended December 31, 2016 and 2015, there were no events that would indicate an impairment of long-lived assets.

Gifts of long-lived assets such as property, plant and equipment are recorded at the fair value at the date of the gift and reported as an increase to unrestricted net assets unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Temporarily and Permanently Restricted Net Assets
Temporarily restricted net assets are those funds whose use by the Hospital has been limited by donors to a specific time period and/or purpose. Once the restrictions are satisfied, or have been deemed to have been satisfied, those temporarily restricted net assets are released from restrictions. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity.

(in thousands)

Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. Management of the Hospital has interpreted the State of New Jersey's enacted version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the historic dollar value of donor-restricted endowment funds (absent explicit donor stipulations to the contrary). Historic dollar value is defined as the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. Based on this interpretation, the Hospital classifies as permanently restricted net assets (a) the original value gifts donated to the permanently restricted net assets (b) the original value of subsequent gifts to the permanent endowment (c) the net realizable value of future payments to permanently restricted net assets in accordance with the donor's gift instrument (outstanding endowment pledges net of applicable discount) and (d) appreciation (depreciation), gains (losses) and income earned on the fund when the donor states that such increases or decreases are to be treated as changes in permanently restricted net assets. The remaining portions 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 Hospital in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the fund;

(2) The purpose of the organization 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 Hospital; and

(7) The investment policies of the Hospital.

The Hospital has a policy of appropriating for distribution each year up to 5% of its endowment fund's average fair value over the prior 12 quarters through the calendar year end preceding the fiscal year in which the distribution is planned. In establishing this policy, the Hospital considered the long-term expected return on its endowment. Accordingly, over the long term, the Hospital expects the current spending policy to allow its endowment to grow at an average of 2.5% annually. This is consistent with the Hospital's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return. This method also compensates for any volatile year-to-year fluctuation in investment returns.

(in thousands)

Management further understands that expenditures from a donor-restricted fund is limited to the uses and purposes for which the endowment fund is established and the use of net appreciation, realized gains (with respect to all assets) and unrealized gains (with respect only to readily marketable assets) is limited to the extent that the fair value of a donor-restricted fund exceeds the historic dollar value of the fund (unless the applicable gift instrument indicates that net appreciation shall not be expended), to the extent that such expenditure is prudent, considering the long and short term needs of the Hospital in carrying out its purposes, its present and anticipated financial requirements, expected total return on its investments and general economic conditions. Under the policies established and approved by the Hospital's Investment Committee, donor-restricted endowment funds are invested in income-generating investment vehicles to generate appreciation and preserve capital.

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. The Hospital's policy is to exclude from excess of revenues over expenses, net assets released from capital restrictions. Net assets released from restrictions for noncapital purposes are included within operating income. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying consolidated financial statements.

Net Patient Service Revenue and Patient Accounts Receivable
Net patient service revenue is accounted for on the accrual basis in the period in which the service is provided. These amounts are net of appropriate allowances to give recognition to differences between the Hospital's charges and reimbursement rates from third party payers. The Hospital is reimbursed from third party payers under various methodologies based on the level of care provided. Certain net revenues received are subject to audit and retroactive adjustment for which amounts are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The net amounts recorded, related to prior years and changes in estimates, increased the performance indicator by approximately $18,500 and $3,800 for the years ended December 31, 2016 and 2015, respectively.

A summary of the payment arrangements with major third-party payers is as follows:

Medicare
Inpatient acute care, behavioral care and rehabilitation services and most outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient subacute services ("SNF") are paid to Medicare beneficiaries at prospectively determined rates per-diem and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain reimbursable items at a tentative rate with final settlement determined after submission of the annual cost report by the Hospital and audits thereof by the Medicare administrative contractor. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. The Hospital's Medicare cost reports have been

(in thousands)

audited and finalized by the Medicare administrative contractor through December 31, 2014 for the Newton and Hackettstown Divisions and 2013 for the Morristown, Chilton and Overlook Divisions, except for the 2012 cost report for the Morristown Division.

Medicaid
Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services are paid based upon a cost reimbursement methodology and certain services are paid based on a Medicaid fee schedule. The Hospital is paid for reimbursable costs at a tentative rate with final settlement determined after submission of the annual cost report by the Hospital and audit thereof by the Medicaid fiscal intermediary. The Hospital's Medicaid cost reports have been audited and finalized by the Medicaid fiscal intermediary through December 31, 2013, except for the Chilton and Hackettstown Divisions which have been audited and finalized through December 31, 2014.

Commercial and Other
The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per day/case and discounts from established charges.

Revenue from the Medicare and Medicaid programs accounted for approximately 43% and 44% of the Hospital's gross patient service revenue for the years ended December 31, 2016 and 2015, respectively. In addition, Commercial and Managed Care payers accounted for approximately 51% and 49% of the Hospital's gross patient service revenue for the years ended December 31, 2016 and 2015, respectively. Self-pay accounted for approximately 3% of the Hospital's gross patient service revenue for both December 31, 2016 and 2015.

Laws and regulations governing the Medicare and Medicaid programs are 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. Noncompliance includes fines, penalties and exclusion from the Medicare and Medicaid programs. The Hospital has established a Corporate Compliance Program to monitor and ensure compliance with various regulations. Except for the settlement noted in Note 13, the Hospital is not aware of any allegations of noncompliance that could have a material adverse effect on the consolidated financial statements and believes that it is in compliance with all applicable laws and regulations.

On February 19, 2004, the Secretary of Health and Human Services confirmed that hospitals can provide discounts for uninsured patients, which allowed the Hospital to implement a discount policy in accordance with state law. The Hospital's goal was to create a financial aid program that is consistent with the mission, values, and capacity of the Hospital, while considering an individual's ability to contribute to his or her care. The Hospital has a policy that provides discounts to uninsured patients. Under this policy, the discount offered to uninsured patients is reflected as a reduction to net patient service revenue at the time the uninsured billings are recorded.

Federal and state law requires that hospitals provide emergency services regardless of a patient's ability to pay. Uninsured patients seen in the emergency department, including patients subsequently admitted for inpatient services, often do not provide information necessary to allow the Hospital to qualify such patients for charity care. Uncollectible amounts due from such

uninsured patients represent the substantial portion of the provision for bad debts reflected in the accompanying consolidated statements of operations. The Hospital records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Other Revenue
Included within other revenue in the consolidated statements of operations are those amounts the Hospital derives from services other than providing health care services to patients, residents and the like such as physician practice revenue, cafeteria sales, parking lot revenue, purchase discounts and various other miscellaneous receipts. Physician practice revenues amounted to $258,524 and $220,189 for the years ending December 31, 2016 and 2015, respectively.

Performance Indicator
The consolidated statements of operations include excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include changes in net unrealized gains (losses) on other than trading securities, net assets released from capital restrictions, government grants used for capital purchases, and unrestricted net asset adjustments to the Hospital's pension liability.

The Hospital differentiates its operating activities through the use of income from operations as an intermediate measure of operations. For the purposes of display, investment income, which management does not consider being a component of the Hospital's operating activities, changes in the value of swap agreements, and losses on refunding/redemption of debt are excluded from the income from operations and reported as nonoperating gains in the consolidated statements of operations.

Fair Value
The Hospital follows guidance related to fair value accounting that establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value requires an organization to determine the unit of account, the mechanism of hypothetical transfer, and the appropriate markets for the asset or liability being measured.

The guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entities own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

(in thousands)

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Hospital for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

Level 1 Quoted market prices in active markets for identical assets or liabilities. Level 1 assets consist of common stock as they are traded in an active market with sufficient volume and frequency of transactions.

Level 2 Quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability. Level 2 assets consist of money market funds and mutual funds that are nonexchange traded and valued based on Net Asset Values (NAVs) calculated by the funds' independent administrators which are calculated at least daily. These valuations are readily observable in the market place or are supported by observable levels at which transactions are executed in the marketplace. As Level 2 investments include positions that are not traded in active markets and/or are subject to transfer restrictions, valuations may be adjusted to reflect illiquidity and /or nontransferability, which are generally based on available market information. Redemptions from each of the funds can be made at least daily on the latest reported NAV.

Level 3 Unobservable inputs for the asset or liability that are supported by little or no market activity and that are significant to the fair value. Level 3 assets consist of beneficial interests in perpetual trusts held by third parties, primarily invested in equities and fixed income securities. The value of these investments represents the Hospitals ownership of the NAV of the respective financial asset.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are as follows:

Market Approach (M) - Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;

Cost Approach (C) - Amount that would be required to replace the service capacity of an asset (i.e., replacement cost); and

Income Approach (I) - Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing models, and lattice models).

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. Inputs are used in applying the various valuation techniques and broadly refer to the assumptions the market participants use to make valuation decisions. Inputs may include price information, credit data, liquidity statistics and other factors. The Hospital utilized the best available information in measuring fair value (Note 6 and 10).

(in thousands)

3. Charity Care

The Hospital provides care to patients who meet certain criteria defined by the New Jersey Department of Health and Senior Services ("DOHSS") without charge or at amounts less than its established rates. The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished. The Hospital receives partial reimbursement for the uncompensated care it provides (Note 4). The estimated amount of charity care provided at cost under DOHSS guidelines during the years ended December 31, 2016 and 2015 amounted to approximately $87,290 and $89,888, respectively.

The estimated charity care cost is based on the calculation of a ratio of cost to gross charges, and then multiplying that ratio by the charity care allowances.

4. Patient Service Revenue and Related Adjustments

The Hospital records gross patient service revenue on an accrual basis at established rates, with contractual and other allowances added to or deducted from such amounts to determine net patient service revenue. The Hospital maintains policies and records to identify and monitor these contractual allowances and its level of charity care. These records include the amount of deductions from gross revenue due to qualified services provided under the State's charity care guidelines.

The process for estimating the ultimate collection of receivables involves significant assumptions and judgments. The Hospital has implemented a monthly standardized approach to estimate and review the collectability of receivables based on the payer classification and the period from which the receivables have been outstanding. Account balances are written off against the allowance when management feels it is probable the receivable will not be recovered. Historical collection and payer reimbursement experience is an integral part of the estimation process related to reserves for doubtful accounts. In addition, the Hospital assesses the current state of its billing functions in order to identify any known collection or reimbursement issues and assess the impact, if any, on reserve estimates. The Hospital believes that the collectability of its receivables is directly linked to the quality of its billing processes, most notably those related to obtaining the correct information in order to bill effectively for the services it provides. Revisions in reserve for doubtful accounts estimates are recorded as an adjustment to bad debt expense.

(in thousands)

Patient service revenue, net of contractual allowances and discounts and provision for bad debts, recognized in the period from these major sources for the years ended December 31, 2016 and 2015 are as follows:

	2016	2015
Gross patient service revenue		
Inpatient	$ 5,591,950	$ 5,130,023
Outpatient	4,219,018	3,646,442
Total gross patient service revenue	9,810,968	8,776,465
Net additions (deductions) from gross patient service revenue		
Contractual and other allowances	(7,452,779)	(6,585,802)
Charity care allowances	(112,867)	(119,637)
Charity care subsidy	4,483	7,238
Special mental health subsidy	360	360
	(7,560,803)	(6,697,841)
Net patient service revenue (net of contractual allowances and discounts)	2,250,165	2,078,624
Provision for bad debts (net of recoveries)	(74,446)	(84,482)
Net patient service revenue, less provision for bad debts	$ 2,175,719	$ 1,994,142

5. Concentration of Credit Risk

The Hospital extends credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. Gross accounts receivable from patients and third-party payers, as of December 31, 2016 and 2015, were as follows:

	2016	2015
Medicare and Medicaid	31 %	27 %
Commercial and other third party payers	37	39
Self pay	20	21
Blue Cross	12	13
	100 %	100 %

(in thousands)

6. Assets Limited as to Use, Long-Term Investments and Other Assets

Assets limited as to use at December 31, 2016 and 2015 consist of the following:

	2016	2015
Board designated for capital and program costs		
Mutual funds - equity securities	$ 578,835	$ 518,280
Mutual funds - debt securities	363,054	333,056
Alternative investments - equity	500	593
	942,389	851,929
Under bond indenture agreements		
Cash and short term investments		
Interest account	2,620	6,944
Principal account	2,074	4,848
Debt service reserve fund	660	14,920
Construction account	-	19,753
Cost of issuance account	113	-
	5,467	46,465
Total assets whose use is limited	947,856	898,394
Less: Assets limited as to use and are required for current liabilities	35,309	41,655
Noncurrent assets limited as to use	$ 912,547	$ 856,739

Assets limited as to use under bond indenture agreements represent certain funds that are controlled by trustees for as long as any of the bonds remain outstanding. These funds, including interest income, are held by bank trustees who administer the trusts as required under the bond indenture agreements.

(in thousands)

Long-term investments and other assets, at December 31, 2016 and 2015, are as follows:

	2016	2015
Long-term investments		
Money market funds	$ 2,259	$ 2,574
Mutual funds - equity securities	27,714	24,413
Mutual funds - debt securities	23,419	21,431
Alternative investments - equity	9,810	11,280
	63,202	59,698
Other assets		
Professional and general liability insurance recoveries	51,009	46,187
Workers compensation liability insurance recoveries	11,630	10,809
Due from Overlook Foundation	6,451	6,791
Due from Newton Medical Center Foundation	1,861	795
Due from Chilton Medical Center Foundation	8,142	8,229
Due from the Foundation for Hackettstown Medical Center	4,098	-
Beneficial interest in trusts	4,989	4,739
Other	18,772	14,011
	106,952	91,561
Total long-term investments and other assets	$ 170,154	$ 151,259

Under current accounting guidance it is the Hospital's policy to accrue an estimate of the ultimate cost of claims under all insurance policies whether the policy is fully insured or a self-insurance policy. In addition, any insurance recoverable under such policies is recorded as a receivable. As of December 31, 2016 and 2015, the Hospital has recorded approximately $51,009 and $46,187, respectively, in other long-term assets for professional and general liability insurance recoveries. The Hospital also recorded $11,630 and $10,809 for workers compensation liability insurance recoveries at December 31, 2016 and 2015, respectively. A corresponding liability for the above is recorded within long-term liabilities. The Hospital also recorded incurred but not reported claims related to workers compensation in the amount of $13,575 and $11,608 to accounts payable and accrued expenses as of December 31, 2016 and 2015, respectively, in the consolidated balance sheets.

Due from Overlook, Newton, Chilton and Hackettstown Medical Center Foundations relate to the amounts due from the Foundations for contributions received by the Foundations on behalf of the Overlook, Newton, Chilton and Hackettstown Divisions. The Foundations solicit funds in their general appeal to support the Hospital and for other health care purposes as the respective Foundation's individual Board of Trustees may deem appropriate. In the absence of donor restrictions, the Foundations have discretionary control over the amounts to be distributed to the providers of health care services, the timing of such distributions, and the purposes for which such funds are used. The assets held at the affiliated foundations are comprised primarily of cash and cash equivalents, marketable equity securities and debt securities.

(in thousands)

Investment income relating to long-term investments and assets limited as to use, excluding those held under bond indenture agreements and restricted funds, for the years ended December 31, 2016 and 2015 consist of the following:

	2016	2015
Interest and dividend income	$ 28,332	$ 32,577
Realized gains (losses) on sales of securities	5,807	(35)
Investment income, included in nonoperating gains, net	34,139	32,542
Change in net unrealized gains (losses) on other than trading securities	39,295	(42,583)
Investment results	$ 73,434	$ (10,041)

The Hospital reinvested interest and dividends earned of approximately $26,971 and $34,872 in 2016 and 2015, respectively.

The fair value of the Hospital's financial assets that are measured on a recurring basis at December 31, 2016 are as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value December 31, 2016	Valuation Technique[(1)]
Assets limited as to use					
Money market funds	$ -	$ 5,467	$ -	$ 5,467	M
Mutual funds - equity securities	-	578,835	-	578,835	M
Mutual funds - debt securities	-	363,054	-	363,054	M
	$ -	$ 947,356	$ -	$ 947,356	
Long-term investments					
Money market funds	$ -	$ 2,259	$ -	$ 2,259	M
Mutual funds - equity securities	-	27,714	-	27,714	M
Mutual funds - debt securities	-	23,419	-	23,419	M
	$ -	$ 53,392	$ -	$ 53,392	
Beneficial interests in perpetual and remainder trusts	$ -	$ -	$ 4,989	$ 4,989	M

(1) The three valuation techniques are Market Value (M), Cost approach (C) and Income Approach (I), as discussed in Note 2.

(in thousands)

Changes in Level 3 investments for the year ended December 31, 2016 was as follows:

	Level 3 Investments
Beginning of year	$ 4,739
Change in unrealized gain	250
End of year	$ 4,989

The fair value of the Hospital's financial assets that are measured on a recurring basis at December 31, 2015 are as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value December 31, 2015	Valuation Technique[(1)]
Cash and cash equivalents					
Money market funds	$ -	$ 850	$ -	$ 850	M
Assets limited as to use					
Money market funds	$ -	$ 46,465	$ -	$ 46,465	M
Mutual funds - equity securities	-	518,280	-	518,280	M
Mutual funds - debt securities	-	333,056	-	333,056	M
	$ -	$ 897,801	$ -	$ 897,801	
Long-term investments					
Money market funds	$ -	$ 2,574	$ -	$ 2,574	M
Mutual funds - equity securities	-	24,413	-	24,413	M
Mutual funds - debt securities	-	21,431	-	21,431	M
	$ -	$ 48,418	$ -	$ 48,418	
Beneficial interests in perpetual and remainder trusts	$ -	$ -	$ 4,739	$ 4,739	M

(1) The three valuation techniques are Market Value (M), Cost approach (C) and Income Approach (I), as discussed in Note 2.

Changes in Level 3 investments for the year ended December 31, 2015 was as follows:

	Level 3 Investments
Beginning of year	$ 5,250
Change in unrealized loss	(511)
End of year	$ 4,739

There were no transfers between levels during the years ended December 31, 2016 and 2015.

(in thousands)

7. Property, Plant and Equipment

Property, plant and equipment, including assets held under capital lease obligations, at December 31, 2016 and 2015 are as follows:

	2016	2015	Depreciable Life (in Years)
Land and land improvements	$ 46,708	$ 35,718	10–50
Buildings and improvements	1,297,737	1,231,673	10–50
Equipment and equipment deposits	1,050,959	993,966	3–25
Construction in progress	75,648	39,922	
	2,471,052	2,301,279	
Less: Accumulated depreciation	1,426,797	1,308,158	
Property, plant and equipment, net	$ 1,044,255	$ 993,121	

Depreciation expense for the years ended December 31, 2016 and 2015 was $127,471 and $120,613, respectively.

Interest costs, net of interest earned, aggregating $185 and $747 were capitalized in 2016 and 2015, respectively.

(in thousands)

8. Long-Term Debt

Long-term debt at December 31, 2016 and 2015 consists of the following:

	2016	2015
$224,800 New Jersey Health Care Facilities Financing Authority ("NJHCFFA"), AHS Hospital Corporation, Series 2016 Refunding Bonds (Fixed Rate), in varying maturities through 2041 at annual interest rates varying between 3.0% and 5.0%. Interest is payable each January 1 and July 1 and principal is payable each July 1 commencing in 2017. As of December 31, 2016, the average interest rate on the bonds was 5.0%. The bonds are collateralized by the Hospital's gross receipts.	$ 224,800	-
$200,000 Series 2015 Taxable Bonds (Fixed Rate) maturing on July 1, 2045. Interest is payable each January 1 and July 1 at an annual interest rate of 5.024%. The bonds are collateralized by the Hospital's gross receipts under the Master Trust Indenture.	200,000	200,000
$50,000 Bank of America Taxable Term Loan maturing on December 1, 2023. Interest is payable monthly at an annual interest rate of 3.85%. The loan is collateralized by the Hospital's gross receipts under the Master Trust Indenture.	50,000	50,000
$130,545 NJHCFFA AHS Hospital Corportation, Series 2011 Revenue Bonds (Fixed Rate), in varying maturities through 2021 at annual interest rates varying between 4.3% and 5.0%. Interest is payable each January 1 and July 1 and principal is payable each July 1 commencing in 2012. As of December 31, 2016, the average interest rate on the bonds was 5.0%. The bonds are collateralized by the Hospital's gross receipts.	4,855	126,195
$177,110 NJHCFFA AHS Hospital Corporation, Series 2008A Revenue Bonds (Fixed Rate), in varying maturities through 2027 at annual interest rates varying between 5.0% and 5.1%. Interest is payable each January 1 and July 1 and principal is payable each July 1 commencing in 2009. As of December 31, 2016, the average interest rate on the bonds was 5.0%. The bonds are collateralized by the Hospital's gross receipts.	5,265	127,990
$177,110 NJHCFFA AHS Hospital Corporation, Series 2008B and 2008C Revenue Bonds (Variable Rate), in varying maturities commencing in 2027 through 2036 at annual interest rate of 4.5%. The interest on the bonds is payable monthly and principal will be payable each July 1. As of December, 31, 2016 and 2015, the average interest rate on the bonds was .41% and .03%, respectively. The bonds are collateralized by the Hospital's gross receipts.	177,110	177,110
$6,000 NJHCFFA Chilton Capital Asset Loan maturing November 30, 2018. Principal and interest is payable monthly at variable interest rates. As of December 31, 2016 and 2015, the average interest rate on the loan was 2.9% and 1.8%, respectively.	1,643	2,500
Total long-term debt	663,673	683,795
Unamortized bond premium (discount)	26,062	1,610
Deferred financing fees	(2,288)	(3,891)
	687,447	681,514
Less: Current portion of long-term debt	8,447	10,501
Long-term debt, net of unamortized bond premium (discount), debt issuance costs, and current portion	$ 679,000	$ 671,013

(in thousands)

Under the terms of the revenue bonds, the Hospital is required to maintain certain deposits with a trustee. Such deposits are included with assets limited as to use in the consolidated balance sheets. The bond agreements also contain provisions whereby certain financial ratios are to be maintained and permit additional borrowings subject to the maintenance of specific financial ratios. The most restrictive covenant is for the Hospital to maintain a debt service coverage ratio in each year of at least 1.25 times the debt service requirement on all long-term debt in that year. The Hospital is compliant with its financial covenants at December 31, 2016 and 2015.

Deferred financing costs representing costs of bond issuances, are being amortized over the life of the bonds.

In October 2016, the Hospital issued $224,800 Series 2016 Fixed Rate Tax-exempt Revenue Bonds through the NJHCFFA. The proceeds were used for the following purposes: (i) refunding a portion of the principal of the Authority's outstanding Series 2008A Revenue Bonds in the amount of $114,255; (ii) refunding a portion of the principal of the Authority's outstanding Series 2011 Revenue Bonds in the amount of $120,115; and (iii) to pay all of the cost of issuance in the amount of $1,782. In addition, the NJHCFFA released $14,260 of the Hospital's debt service reserve fund in connection with the bond refunding to pay down a portion of the aforementioned outstanding principal on the Series' 2008A and 2011 bonds. The Hospital recorded a loss on refunding of $33,482, which included the write-off of the bond discount / premium and all deferred financing costs related to the refunded debt.

In May 2015, the Hospital issued $200,000 Series 2015 Fixed Rate Taxable Bonds, the proceeds of which will be used for eligible corporate purposes of the Hospital and its affiliates. In addition, a portion of the proceeds were used to pay the costs of issuance in the amount of $595. The principal is due in its entirely on July 1, 2045 and interest is payable each January 1 and July 1 at an annual interest rate of 5.024%. The agreement contains provisions whereby certain financial ratios are to be maintained which mirror those of the Hospital's outstanding tax-exempt bond covenants.

In December 2013, the Hospital entered into a $50,000 taxable loan agreement with a commercial bank. The majority of the $50,000 of loan proceeds were used on January 2, 2014 to legally defease Chilton Division's NJHCFFA Series 2009 Revenue Bonds, which were assumed by the Hospital on the effective date of the merger. With regards to the defeasance, the Hospital recorded a loss on redemption of $7,073 within the consolidated statement of operations in nonoperating gains, net. The principal on the bank loan is due in its entirety on December 1, 2023 and interest is payable monthly at an annual interest rate of 3.85%. The agreement contains provisions whereby certain financial ratios are to be maintained which mirror those of the Hospital's outstanding tax-exempt bond covenants.

In May 2011, the Hospital issued $130,545 Series 2011 Fixed Rate Revenue Bonds, the proceeds of which will be used to pay for the costs or to reimburse the Hospital for certain capital expenditures related to (a) the renovation and equipping of the Hospital's existing hospital facilities and (b) the acquisition and installation of equipment to be located at the Hospital's facilities. In addition, the proceeds were used to pay the costs of issuance of the 2011 Bonds and to refund the NJHCFFA Newton Memorial Hospital Issue, Series 1997 Revenue and Refunding Bonds. In addition, upon acquisition of the Newton Division on April 1, 2011, the Hospital assumed the Newton Memorial Hospital 2001 Revenue Bond Issue. The Newton Series 2001 Revenue Bonds were subsequently refunded in December 2014 at a minimal loss of $34 which had been recorded

(in thousands)

within the consolidated statement of operations as a loss within nonoperating gains, net. The Newton Division Master Trust Indenture was discharged and the 2001 Revenue Bonds included within the AHS Hospital Corp. Master Trust Indenture. In connection with the issuance of the Series 2016 Refunding Bonds noted above, $120,115 of the outstanding principal was refunded in October 2016.

In May 2008, the Hospital issued $177,110 Series 2008A Revenue Bonds (Fixed Rate) and $177,110 Series 2008B and 2008C Revenue Bonds (Variable Rate), collectively referred to as the 2008 Bonds, to pay in full the Hospital's obligations under the interim method of financing enabling the Hospital to redeem all of its outstanding bond issues and terminate a portion of its related swaps for the Series 2003, 2004, 2006 and 2007 Revenue Bonds. The proceeds of the 2008 Bonds were also used to pay the costs of issuance of the 2008 Bonds. The Series 2006 and Series 2007 Revenue Bonds were issued in part to pay for the costs of certain capital projects of the Hospital and construction trustee funds were set up for disbursement for the payment of such costs. Amounts equal to the amounts on deposit in such construction funds were deposited with the trustee for the 2008 proceeds to complete those projects. In connection with the issuance of the Series 2016 Refunding Bonds noted above, $114,255 of the outstanding principal was refunded in October 2016.

The 2008 Variable Rate Bonds bear interest at weekly rates as determined by the remarketing agent. In the event that the purchase price of the corresponding Series of the Variable Bonds are not remarketed at the corresponding principal amount of such Series, the Variable Bonds are backed by a separate, irrevocable direct pay letters of credit by two banks, each expiring September 2018.

Upon acquisition of the Chilton Division, effective January 1, 2014, the Hospital assumed the capital asset loan entered in to with the NJHCFFA in November 2011 in the original amount of $6,000 for the purpose of installing certain information system technology.

The future principal payments on long-term debt are as follows:

2017	$	7,477
2018		188,456
2019		11,085
2020		10,535
2021		11,065
Thereafter		435,055
	$	663,673

(in thousands)

Interest Swaps

On April 9, 2008, the Hospital unwound and reissued a new barrier swap ("2008 Swap") in place of the 2006A Swap when the Series 2006A Revenue Bonds were redeemed. This was a noncash transaction. The original notional amount of the swap was $91,550 subject to reduction in the principal amortization of a portion of the Hospital's Series 2008 variable rate debt and will expire on July 1, 2036, with an annual fee of .5143%. The notional amount of the swap at December 31, 2016 and 2015 was $91,550. Under the terms of the swap agreement, if the Securities Industry and Financial Markets Association ("SIFMA"), formerly known as the Bond Market Association, Municipal Swap Index, exceeds 4.05% for 90 days, the Hospital will pay a fixed rate of 4% in addition to the annual fee of .5143%. The Hospital will then receive 68% of LIBOR and pay the counterparty 4%. Currently the swap is treated as an ineffective swap for accounting purposes until SIFMA exceeds 4.05% for 90 days, at that time the swap will be tested to determine if it qualifies as a cash flow hedge.

The following table presents the liability, recorded in accrued employee benefits and other, net of current portion, which has been accounted for at fair value, at Level 2, as of December 31, 2016 and 2015:

	2016	2015
2008 interest rate swap	$ 8,269	$ 8,232

The following table sets forth the effect of the 2008 interest rate swap agreement on the consolidated statements of operations for the years ended December 31, 2016 and 2015:

	Amount of (Loss) Gain Recognized in the Performance Indicator	
	2016	2015
Derivative in nonhedging relationship		
Nonoperating gains, net	$ (37)	$ 386

On April 9, 2008, the Hospital unwound and reissued a new barrier swap ("2004 Swap") in place of the 2004 Swap when the Series 2003 and 2004 Revenue Bonds were redeemed. This was a noncash transaction and there were no changes to the terms of the swap. The notional amount of the swap was $97,525, subject to reduction in the principal amortization of a portion of the Hospital's Series 2008 variable rate debt and will expire on July 1, 2025, with an annual fee of 0.524%. The notional amount of the swap at December 31, 2016 and 2015 was $36,650 and $39,900, respectively. Under the terms of the swap agreement, if SIFMA exceeds 4.05% for 90 days, the Hospital will pay a fixed rate of 4% in addition to the annual fee of .524%. The Hospital will then receive 68% of LIBOR and pay the counterparty 4%. Currently the swap is treated as an ineffective swap for accounting purposes until SIFMA exceeds 4.05% for 90 days, at that time the swap will be tested to determine if it qualifies as a cash flow hedge.

(in thousands)

The following table presents the liability, recorded in accrued employee benefits and other, net of current portion, which has been accounted for at fair value, at Level 2, as of December 31, 2016 and 2015:

	2016	2015
2004 interest rate swap	$ 920	$ 1,087

The following table sets forth the effect of the 2004 interest rate swap agreement on the consolidated statements of operations for the years ended December 31, 2016 and 2015:

	Amount of Gain Recognized in the Performance Indicator	
	2016	2015
Derivative in nonhedging relationship		
Nonoperating gains, net	$ 167	$ 184

In accordance with the above swap agreements, the Hospital is required to fund a cash collateral account if the market value of the combined swaps exceeds the trigger amount of $12,000. As of December 31, 2016 and 2015, the combined market value of the swaps was below the trigger and as such, no collateral was required by the counterparty.

9. Operating Leases

The Hospital has several operating leases for equipment and office space. Rental expense for these leases was approximately $36,777 and $33,475 for 2016 and 2015, respectively.

Minimum annual rentals under all operating leases are as follows:

2017	$ 36,549
2018	29,443
2019	24,496
2020	21,539
2021	19,449

10. Pension and Other Postretirement Benefit Plans

The Hospital maintains a defined benefit cash balance pension plan covering substantially all full-time employees, as well as various supplemental retirement plans, which provide pension benefits to certain key executives. The Hospital's funding policy provides that payments to the pension plan shall at least be equal to the minimum funding requirement of the Employee Retirement Income Security Act of 1974 ("ERISA") plus additional amounts, which may be approved by the Hospital from time to time. Effective January 1, 2014, the cash balance pension plan has been frozen to new employees hired after December 31, 2013.

(in thousands)

Chilton Division had a noncontributory defined benefit retirement plan ("Chilton Plan") covering substantially all of its full-time employees. The Chilton Division's funding policy provided that payments to the pension plan shall at least be equal to the minimum funding requirement of the Employee Retirement Income Security Act of 1974 ("ERISA") plus additional amounts, which may be approved by the Hospital from time to time. Effective June 20, 2012, the Chilton Plan was frozen to all future benefits while preserving all benefits that had accrued as of June 30, 2012. Chilton Division was required to fund the Chilton Plan for benefit obligations. As of December 31, 2014, the Chilton Plan merged its assets and liabilities with the Cash Balance Plan.

The Hospital sponsors three defined benefit postretirement plans at the Morristown and Overlook Divisions and formerly owned General Hospital Center at Passaic (the "General"). A description of the individual site plans are as follows:

The Morristown Division plan pays the cost of providing medical and life insurance postretirement benefits to employees and qualifying dependents (spouse or child) of the Hospital who retire under the retirement plan and meet the specified age and service requirements. Contributions were introduced beginning in 2003 for all current and future retirees.

The Overlook Division plan provides postretirement medical benefits to eligible employees and their qualifying dependents (spouse or child). The benefits for services provided outside the Hospital are subject to deductibles and co-payments. There is no charge for services provided in the Hospital except for prescription drugs, which are charged at cost. In addition, the Hospital provides postretirement life insurance coverage for employees hired prior to July 2, 1995.

The General plan provides for life insurance and medical benefits for certain employees retired as of the July 1996 amendment date.

In May 1996, the Morristown Division and Overlook Division postretirement plans were amended to exclude new employees from participation in either plan. In July 1996, the General's postretirement plan was amended to exclude all active employees from the plan who had not retired as of the amendment date.

(in thousands)

The following tables provide a reconciliation of the changes in the plans' benefit obligation and fair value of assets for the years ended December 31, 2016 and 2015, a statement of the funded status of the plans and, the amounts recognized in the consolidated balance sheets as of December 31, 2016 and 2015.

	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
Accumulated benefit obligation	$ 882,198	$ 842,669	$ -	$ -
Change in benefit obligation				
Benefit obligation at beginning of year	$ 849,013	$ 848,663	$ 136,486	$ 128,120
Service cost	34,742	33,335	1,236	1,469
Interest cost	40,108	37,332	6,202	5,691
Plan participant's contributions	-	-	706	686
Actuarial loss (gain)	36,043	(18,249)	4,041	5,451
Settlements	(1,394)	-	-	-
Benefits paid	(68,761)	(52,068)	(5,777)	(4,931)
Benefit obligation at end of year	889,751	849,013	142,894	136,486
Change in plan assets				
Fair value of plan assets at beginning of year	687,281	691,902	70,204	74,626
Actual return on plan assets	34,052	(3,367)	8,398	(918)
Employer contributions	49,387	50,814	573	741
Plan participant's contributions	-	-	706	686
Settlements	(1,394)	-	-	-
Benefits paid	(68,761)	(52,068)	(5,777)	(4,931)
Fair value of plan assets at end of year	700,565	687,281	74,104	70,204
Funded status	$ (189,186)	$ (161,732)	$ (68,790)	$ (66,282)
Amounts recognized in the consolidated balance sheets consist of				
Current liabilities	$ (302)	$ (322)	$ (660)	$ (730)
Long-term liabilities	(188,884)	(161,410)	(68,130)	(65,552)
Net amount recognized	$ (189,186)	$ (161,732)	$ (68,790)	$ (66,282)
Amounts recognized in unrestricted net assets consist of				
Actuarial net loss	$ 264,174	$ 227,864	$ 40,524	$ 44,054
Prior service credit	(5,255)	(8,057)	-	(21)
	$ 258,919	$ 219,807	$ 40,524	$ 44,033

For measurement purposes, the postretirement plans assumed a 7.75% annual rate of increase in the per capita cost of covered health care benefits for 2017. The rate was assumed to decrease gradually to 3.9% for 2075 and remain at that level thereafter.

The combined effect of a 1% change in these assumed cost trend rates would increase or (decrease) the benefit obligation by approximately $24,272 or ($19,639), respectively. In addition, a 1% change would increase or (decrease) the aggregate service and interest cost components of net periodic postretirement health-care cost by approximately $1,382 or ($1,100), respectively.

(in thousands)

The following tables provide the components of the net periodic pension and other postretirement benefit costs as of December 31, 2016 and 2015 and the total amount recognized in net periodic benefit cost and changes in unrestricted net asset for the years ended December 31, 2016 and 2015:

	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
Net periodic benefit cost				
Service cost	$ 34,741	$ 33,335	$ 1,236	$ 1,469
Interest cost	40,108	37,332	6,202	5,691
Expected return on plan assets	(47,772)	(48,713)	(4,807)	(5,136)
Settlement charge	451	-	-	-
Amortization of unrecognized net gain	13,002	15,073	3,945	3,264
Amortization of unrecognized prior service credit	(2,802)	(2,812)	(21)	(97)
Net periodic benefit cost	37,728	34,215	6,555	5,191
Amounts recognized in unrestricted net assets				
Net loss	49,763	33,831	415	11,401
Amortization of net gain	(13,002)	(15,073)	(3,945)	(3,264)
Recognition due to settlement	(451)	-	-	-
Recognized change in unrestricted net assets	2,802	2,812	21	97
	39,112	21,570	(3,509)	8,234
Total recognized in net periodic benefit cost and change in unrestricted net assets	$ 76,840	$ 55,785	$ 3,046	$ 13,425

The actuarial net loss and prior service credit for the pension plans will be amortized from unrestricted net assets into net periodic benefit cost in 2017 are $16,107 and ($2,795), respectively. The actuarial net loss and prior service credit for other postretirement benefits will be amortized from unrestricted net assets into net periodic benefit cost in 2017 are $3,753 and $0, respectively.

Assumptions used in determining the net periodic benefit cost and the benefit obligations are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
Benefit obligations				
Discount rate	4.60 %	4.90 %	4.71 %	4.63 %
Rate of compensation increase	3.00	3.00	3.00	3.00
Net periodic benefit cost				
Discount rate	4.90 %	4.51 %	4.63 %	4.52 %
Expected return on plan assets	7.00	7.00	7.00	7.00
Rate of compensation increase	3.00	3.00	3.00	3.00

(in thousands)

The Hospital considers multiple factors in establishing a multi-year projected return assumption for its benefit programs. These include, but are not limited to: its current asset allocation policy and target ranges by asset class; asset valuations; historical and projected rates of return by asset class; historical and projected correlations among asset classes; the opportunity to exceed passive index returns via active management through a combination of manager selection and alternative weightings among and within asset classes; and the Hospital's historical performance experience.

The Overlook Division and General Division postretirement plans are unfunded. The Overlook Division plan has an aggregate benefit obligation of $8,681and $11,207 for 2016 and 2015, respectively. The General Division plan has an aggregate benefit obligation of $1,859 and $2,065 for 2016 and 2015, respectively.

Expected Benefit Payments
The benefits expected to be paid in each year from 2017 to 2026 are:

		Other Postretirement Benefits	
	Pension Benefits	Without Medicare Subsidy	With Medicare Subsidy
2017	$ 65,512	$ 4,432	$ 4,156
2018	54,819	4,897	4,575
2019	56,984	5,486	5,112
2020	61,523	5,973	5,540
2021	64,974	6,559	6,059
2022–2026	355,460	40,758	37,048

The aggregate benefits expected to be paid are based on the same assumptions used to measure the benefit obligation at December 31, 2016 and include estimated future employee service.

Plan Assets
The Plans' weighted average asset allocation is as follows:

	Percentage of Plan Assets					
	Defined Benefit Plans			Other Postretirement Benefits		
Asset Category	Target Allocation	2016	2015	Target Allocation	2016	2015
Equity securities	60–70%	53 %	56 %	60–85%	90 %	85 %
Debt securities	20–30%	32	40	20–30%	9	14
Other	0–10%	15	4	0–5%	1	1
		100 %	100 %		100 %	100 %

(in thousands)

The following table summarizes the Cash Balance Plan's financial instruments, not included with the Hospital's consolidated balance sheets, measured at fair value on a recurring basis by caption and by level within the valuation hierarchy as of December 31, 2016:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value December 31, 2016	Valuation Technique[(1)]
Plan assets					
Money market funds	$ -	$ 101,445	$ -	$ 101,445	M
Mutual funds - equity securities	-	369,987	-	369,987	M
Mutual funds - debt securities	-	222,207	-	222,207	M
	$ -	$ 693,639	$ -	$ 693,639	

(1) The three valuation techniques are market approach (M), cost approach (C), and income approach (I), as discussed in Note 2.

The following table summarizes the Cash Balance Plan's financial instruments, not included with the Hospital's consolidated balance sheets, measured at fair value on a recurring basis by caption and by level within the valuation hierarchy as of December 31, 2015:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value December 31, 2015	Valuation Technique[(1)]
Plan assets					
Money market funds	$ -	$ 21,171	$ -	$ 21,171	M
Mutual funds - equity securities	-	384,479	-	384,479	M
Mutual funds - debt securities	-	273,307	-	273,307	M
	$ -	$ 678,957	$ -	$ 678,957	

(1) The three valuation techniques are market approach (M), cost approach (C), and income approach (I), as discussed in Note 2.

(in thousands)

The following table summarizes the Postretirement Plan's financial instruments, not included with the Hospital's consolidated balance sheets, measured at fair value on a recurring basis by caption and by level within the valuation hierarchy as of December 31, 2016:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value December 31, 2016	Valuation Technique[(1)]
Postretirement plan assets					
Money market funds	$ -	$ 744	$ -	$ 744	M
Mutual funds - equity securities	-	66,632	-	66,632	M
Mutual funds - debt securities	-	6,728	-	6,728	M
	$ -	$ 74,104	$ -	$ 74,104	

(1) The three valuation techniques are market approach (M), cost approach (C), and income approach (I), as discussed at Note 2.

The following table summarizes the Postretirement Plan's financial instruments, not included with the Hospital's consolidated balance sheets, measured at fair value on a recurring basis by caption and by level within the valuation hierarchy as of December 31, 2015:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value December 31, 2015	Valuation Technique[(1)]
Postretirement plan assets					
Money market funds	$ -	$ 709	$ -	$ 709	M
Mutual funds - equity securities	-	59,501	-	59,501	M
Mutual funds - debt securities	-	9,994	-	9,994	M
	$ -	$ 70,204	$ -	$ 70,204	

(1) The three valuation techniques are market approach (M), cost approach (C), and income approach (I), as discussed at Note 2.

Investment Strategy

The Hospital's investment objective is to achieve the highest reasonable total return after considering (i) plan liabilities, (ii) funding status and projected cash flows, (iii) projected market returns, valuations and correlations for various asset classes, and (iv) the Hospital's ability and willingness to incur market risk. The Hospital actively manages plan assets in order to add incremental returns by manager selection and asset allocation (increasing/decreasing allocations within allowable ranges based on current and projected valuations).

Expected Contributions

Based on the funded status of the cash balance plan as of December 31, 2016, the Hospital expects to contribute $48,000 to this pension plan during fiscal year 2017. This will be evaluated

(in thousands)

on a quarterly basis. There are no required contributions to be made to the various supplemental plans.

11. Professional and General Liability Self Insurance

The Morristown, Overlook, Newton, Chilton (effective June 1, 2016) and Hackettstown (effective April 1, 2016) Divisions and the Mountainside Division (up through the date of the sale of the Mountainside Division in May 2007) are covered by the Parent for general and professional liability through a captive insurance company, AHS Insurance Company, Ltd. (the "Captive").

Under this plan, for the time period January 1, 2002 to December 31, 2002 primary insurance coverage was provided for the above five divisions and its employees at $5,000 per occurrence and $12,000 annual aggregate. For the time period January 1, 2003 to February 1, 2004 primary insurance coverage was provided at $7,000 per occurrence and $21,700 annual aggregate. For the time period February 1, 2004 to March 1, 2008 primary insurance coverage was provided at $10,000 for each and every occurrence. Subsequent to March 1, 2008, the per occurrence loss limits are $2,000 for each medical incident in respect of insured individuals, except for OBGYN medical professionals where are provided with $3,000 for each medical incident, $2,000 each general liability loss, and $250 per incident with a $15,000 aggregate limit in respect of all other covered entities where charitable immunity in accordance with the provisions of the New Jersey statutory cap applies. The coverage for all other covered entities is limited to $10,000 without aggregate where these provisions do not apply. These policies were written on a claims-made basis. In addition to these claims-made coverages, the Hospital has obtained tail coverages from the Captive.

Prior to September 1, 2004, claims relating to before January 1, 2002, were covered by the Parent under a self-insurance plan. Under this plan, primary insurance coverage is provided at $5,000 per occurrence and $12,000 annual aggregate. Insurance in excess of primary coverage has been purchased from commercial insurance carriers which provide general and professional liability coverage of $60,000 per occurrence and annual aggregate for professional liability and $60,000 per occurrence and annual aggregate for general liability. Effective September 1, 2004, the Parent's self-insurance assets and liabilities were transferred to the Captive. In conjunction with this transfer the Hospital obtained two, three-year renewable bank letters of credit for a total of $10,000 to support the Parent's payable. The Captive is the beneficiary of the letters of credit and can only draw down on the letter of credit, after the Captive's other assets are exhausted. As of December 31, 2016 and 2015, no amounts are outstanding under the letters of credit.

As of December 31, 2016 and 2015, the claims liability recognized by the Captive has been actuarially determined to approximate $51,216 and $45,108, respectively. The Captive has recorded approximately $74,896 and $69,182 at December 31, 2016 and 2015, of investments held at the Captive for general and professional liability coverage.

The Hospital has recorded the claims liability recognized by the Captive, net of amounts related to affiliated Parent entities, in the amount of $51,009 and $44,921 in accrued employee benefits and other long-term liabilities and a corresponding long-term other asset for the amount recoverable from the Captive as of December 31, 2016 and 2015, respectively.

(in thousands)

The Chilton Division maintained an internal risk management program and carried full commercial insurance prior to merging with the Hospital. The insurance coverage provided for the Chilton Division and employed physicians is $1,000 per occurrence and $3,000 in aggregate. In addition, the Chilton Division had excess liability coverage in the amount of $15,000 per occurrence and $15,000 in aggregate.

The Chilton Division has also recorded an actuarially determined liability relating to unasserted claims and incidents incurred but not reported to its insurance carrier based on past lag experience and industry experience data. The estimated undiscounted professional liabilities for incidents that have been incurred but not yet reported amounted to approximately $2,248 and $2,099 at December 31, 2016 and 2015, respectively, and is recorded in accrued benefits and other, net of current portion in the accompanying consolidated balance sheets.

The Hospital is subject to claims in the ordinary course of its business. Management and its legal counsel do not believe these claims will be in excess of the recorded liability.

12. Related Party Transactions

Due from affiliates, net, as of December 31, 2016 and 2015 consists of the following and are recorded in other current assets and long-term investments and other assets in the consolidated balance sheets:

	2016	2015
Other current assets		
Atlantic Ambulance	$ 23,713	$ 24,808
Due from affiliated foundations	824	1,449
AHSIC	2,936	3,700
Parent	26,472	19,616
Primary Care Partners	1,137	1,166
Atlantic ACO	943	869
Loans receivable from AHSIC	-	20,069
	56,025	71,677
Long-term investments and other assets		
Due from affiliated foundations	20,552	15,815
Amounts due from related parties	76,577	87,492
Less: Allowance for doubtful accounts	(19,857)	(21,192)
Due from related parties, net	$ 56,720	$ 66,300

(in thousands)

The Hospital is reimbursed by the above related parties for operating costs paid by the Hospital on their behalf. These costs include but are not limited to payroll and employee benefits, office charges and supplies and other expenses of the related party as warranted. In addition, the due from affiliated foundations include amounts donated to the affiliated foundations for the benefit of the Hospital. The amounts are held by the affiliated foundations until the purpose and/or time restriction has been met. On June 1, 2015, the Hospital entered into two separate 15 year loan agreements with AHSIC in the aggregate principal amount of $20,690 and as such had recorded a current receivable from AHSIC. The proceeds of the loans were utilized by AHSIC to purchase two properties on Madison Avenue in Morristown, NJ. Principal and interest on the loans are payable monthly to the Hospital at a fixed annual interest rate of 3.45%. The notes were classified in the consolidated balance sheet as of December 31, 2016 as other current assets as AHSIC completed a financing with a bank and repaid the Hospital in full with the proceeds on March 30, 2016.

The Hospital, as lessee, contracts for operating leases with AHSIC. The classes of equipment leased and payments under the leases are as follows:

	December 31,	
	2016	**2015**
Medical office buildings, apartments, houses and office space for hospital employees	$ 4,089	$ 4,000

The future minimum commitments under these leases are as follows:

2017	$ 5,262
2018	4,090
2019	1,575
2020	1,609
2021	1,652
Total minimum lease commitments	$ 14,188

13. Commitments and Contingencies

At December 31, 2016, information technology contracts of $20,521 and construction contracts and purchases of equipment of $18,162 exist for on-going capital projects at the various Hospital divisions.

The Hospital is subject to complaints, claims and litigation which have risen in the normal course of business. In addition, the Hospital is subject to reviews by various federal and state government agencies to assure compliance with applicable laws, some of which are subject to different interpretations. While the outcome of these suits cannot be determined at this time, management, based on advice from legal counsel, believes that any loss which may arise from these actions will not have a material adverse effect on the financial position or results of operations of the Hospital.

(in thousands)

On June 25, 2015, the New Jersey State Tax Court ruled in favor of the Town of Morristown and its claim that Morristown Medical Center did not substantially meet the property tax-exemption requirements for certain portions of the hospital, and should be subject to local property tax for the years 2006 through 2008, the years at issue in the case. On November 11, 2015, the Hospital and the Town of Morristown announced that they had reached a settlement of the dispute.

The agreement resolves outstanding property tax disputes relating to the Morristown Division for the years 2006 through 2008 and provides for future property tax payments through 2025. Under the agreement, the Morristown Division will pay the Town $15,500 related to those case years with a $10,000 payment up front and the remaining $5,500 of penalties and interest over the next 10 years. The Hospital paid the $10,000 in December 2015 and its allocated penalty and interest payment of $550 in February 2016. In addition, beginning in 2016 and through 2025, the Hospital also agreed to make an annual tax payment in the amount of $1,050. The ruling relates solely to the Morristown Division's eligibility for property tax exemption under New Jersey law, and has no impact on the not-for-profit status of the Hospital or its federal tax-exempt status under Internal Revenue Code Section 501(c)(3).

During 2012, the Hospital settled a lawsuit relating to inpatient Medicare claim classifications at Overlook Medical Center. The lawsuit alleged that, between 2002 and 2009, the Overlook Division submitted inpatient claims to Medicare for patients who allegedly did not meet inpatient criteria and should have been submitted as outpatients. The Hospital admits no wrongdoing and paid approximately $9,000 to settle. As part of the settlement, the Hospital has entered into a five-year Corporate Integrity Agreement with the Office of the Inspector General of the US Department of Health and Human Services under which the Overlook Division and the Hospital has implemented and maintains a set of internal processes intended to ensure compliance.

14. Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services at December 31, 2016 and 2015 are as follows:

	2016	2015
Health care services	$ 2,024,168	$ 1,833,523
General and administrative	329,617	313,731
	$ 2,353,785	$ 2,147,254

(in thousands)

15. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	December 31, 2016	December 31, 2015
Research	$ 8,894	$ 9,101
Construction projects	7,542	10,228
Purchase of plant and equipment	25,520	24,683
Scholarships and education	5,779	5,382
Program services	37,653	29,138
	$ 85,388	$ 78,532

Permanently restricted net assets are restricted to:

	December 31, 2016	December 31, 2015
Donor-restricted endowment funds	$ 50,028	$ 48,958

During 2016 and 2015, net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose of purchasing equipment in the amounts of $10,064 and $13,340, respectively, and other noncapital purposes in the amounts of $18,321 and $18,202, respectively.

16. Hackettstown Medical Center Acquisition

On January 28, 2014, the Hospital and Adventist HealthCare, Inc. (“Adventist”), a Maryland based healthcare system, agreed to transfer ownership of Hackettstown Community Hospital d/b/a Hackettstown Regional Medical Center, a 111-bed acute care hospital located in Hackettstown, NJ from Adventist HealthCare, Inc. to the Hospital. Until the acquisition described in the following paragraph occurred, the Hackettstown Division was a New Jersey not-for-profit corporation organized as described in Section 501(c)(3) of the Internal Revenue Code.

The Hospital submitted its application for the Certificate of Need (“CN”) with the New Jersey Department Health and Senior Services, and the public hearing was held on June 30, 2014. The New Jersey State Health Planning Board unanimously recommended approval of the CN application at its meeting on July 10, 2014 and it was also approved by the Commissioner of Health on May 1, 2015. The New Jersey Attorney General under the Community Health Care Assets Protection Act (“CHAPA”) approved the transaction on March 3, 2016. The final step was the approval and order by the Superior Court of New Jersey, Chancery Division, which was received on March 16, 2016.

As noted in Note 1, the Hackettstown Division was acquired from Adventist, effective April 1, 2016, with the Hospital substituted as the sole corporate member of Hackettstown Community Hospital and Adventist agreed that the acquisition would improve their ability to provide comprehensive health services and better serve the public interests to residents of Warren County through expanded programs and activities established to improve the health of the community. As a result

(in thousands)

of the acquisition, the Hospital paid $47,000 and assumed certain net assets of the Hackettstown Division, as summarized in the table below. The change in control of the Hackettstown Division was accounted for by the Hospital as an acquisition under the Merger and Acquisition guidance for Not-for-Profit entities. The consolidated statement of operations of the Hospital reflects a decrease in unrestricted net assets of ($872) reflecting the operations of the Hackettstown Division from the date of acquisition to year end.

The fair value of assets acquired, liabilities assumed and the net assets of the Hackettstown Division at April 1, 2016 were as follows:

Assets	
Inventories	$ 1,023
Long-term investments and other assets	3,260
Property, plant and equipment, net	44,852
Goodwill	1,454
Total assets acquired	$ 50,589
Liabilities	
Accrued expenses	$ 1,938
Total liabilities assumed	1,938
Net Assets	
Unrestricted	47,053
Temporarily restricted	1,598
Total net assets	48,651
Total liabilities and net assets	$ 50,589

A summary of the financial results of Hackettstown Medical Center included in the consolidated financial statement of operations from the period April 1, 2016 through December 31, 2016 are as follows:

Total operating revenues	$ 54,836
Deficiency of revenues over expenses	(872)
Decrease in unrestricted net assets	$ (872)

(in thousands)

A summary of the unaudited proforma financial results of the Hospital and the Hackettstown Division for the years ending December 31, 2016 and 2015 as if the acquisition had occurred on January 1, 2015 are as follows:

	2016		
	Hospital	Hackettstown Division	Total
Total operating revenues	$ 2,411,368	$ 77,190	$ 2,488,558
Excess of revenues over expenses	113,594	1,947	115,541
Change in net unrealized gains (losses) on investments	39,295	-	39,295
Net assets released from capital restriction	10,064	(487)	9,577
Government grants used for capital purchases	283	-	283
Change in funded status of benefit plans	(35,603)	-	(35,603)
Increase in unrestricted net assets	$ 127,633	$ 1,460	$ 129,093

	2015		
	Hospital	Hackettstown Division	Total
Total operating revenues	$ 2,240,323	$ 86,973	$ 2,327,296
Excess of revenues over expenses	126,582	5,595	132,177
Change in net unrealized gains (losses) on investments	(42,583)	-	(42,583)
Net assets released from capital restriction	13,340	36	13,376
Government grants used for capital purchases	71	-	71
Change in funded status of benefit plans	(29,804)	-	(29,804)
Increase in unrestricted net assets	$ 67,606	$ 5,631	$ 73,237

17. Subsequent Events

Subsequent events have been evaluated through April 13, 2017, which is the date the consolidated financial statements were issued. No subsequent events have occurred that require disclosure in or adjustment to the consolidated financial statements.