December 31, 2016

2016 Audited Financial Statements

Sutter Health

Sutter Health and Affiliates

Consolidated Financial Statements

Years ended December 31, 2016 and 2015

Contents

Audited Consolidated Financial Statements

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Report of Independent Auditors

The Board of Directors
Sutter Health and Affiliates

We have audited the accompanying consolidated financial statements of Sutter Health and Affiliates, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sutter Health and Affiliates at December 31, 2016 and 2015, and the consolidated results of their operations and changes in net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 7, 2017

Sutter Health and Affiliates

Consolidated Balance Sheets

(Dollars in millions)

	December 31, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	**$ 426**	$ 477
Short-term investments	**4,374**	3,621
Patient accounts receivable (net of allowance for doubtful accounts of $146 in 2016 and $144 in 2015)	**1,264**	1,252
Other receivables	**534**	301
Inventories	**112**	106
Other	**134**	135
Total current assets	**6,844**	5,892
Non-current investments	**667**	609
Property, plant and equipment, net	**7,735**	7,402
Other non-current assets	**428**	441
	$ 15,674	$ 14,344
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 494**	$ 443
Accrued salaries and related benefits	**632**	561
Other accrued expenses	**625**	549
Current portion of long-term obligations	**201**	49
Total current liabilities	**1,952**	1,602
Non-current liabilities:		
Long-term obligations, less current portion	**4,138**	3,659
Other	**1,086**	1,007
Net assets:		
Unrestricted controlling	**7,946**	7,581
Unrestricted noncontrolling	**112**	108
Temporarily restricted	**296**	251
Permanently restricted	**144**	136
	8,498	8,076
	$ 15,674	$ 14,344

See accompanying notes.

Sutter Health and Affiliates

Consolidated Statements of Operations and Changes in Net Assets

(Dollars in millions)

	Year ended December 31, 2016	2015
Unrestricted net assets:		
Operating revenues:		
Patient service revenues	**$ 10,514**	$ 9,733
Provision for bad debts	**(224)**	(175)
Patient service revenues less provision for bad debts	**10,290**	9,558
Premium revenues	**1,160**	1,063
Contributions	**9**	8
Other	**414**	369
Total operating revenues	**11,873**	10,998
Operating expenses:		
Salaries and employee benefits	**5,347**	4,987
Purchased services	**3,026**	2,842
Supplies	**1,319**	1,257
Depreciation and amortization	**676**	619
Rentals and leases	**170**	160
Interest	**138**	121
Insurance	**17**	12
Other	**810**	713
Total operating expenses	**11,503**	10,711
Income from operations	**370**	287
Investment income	**23**	78
Change in net unrealized gains and losses on investments classified as trading	**229**	(220)
Income	**622**	145
Less income attributable to noncontrolling interests	**(68)**	(64)
Income attributable to Sutter Health	**554**	81

Sutter Health and Affiliates

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

(Dollars in millions)

	Year ended December 31, 2016	2015
Unrestricted net assets (continued):		
Unrestricted controlling net assets:		
Income attributable to Sutter Health	**$ 554**	$ 81
Change in net unrealized gains and losses on investments classified as other-than-trading	**15**	7
Net assets released from restriction for equipment acquisition	**9**	14
Pension-related changes other than net periodic pension cost	**(214)**	(32)
Other	**1**	2
Increase in unrestricted controlling net assets	**365**	72
Unrestricted noncontrolling net assets:		
Income attributable to noncontrolling interests	**68**	64
Distributions	**(66)**	(71)
Other	**2**	36
Increase in unrestricted noncontrolling net assets	**4**	29
Temporarily restricted net assets:		
Contributions	**65**	33
Investment income	**5**	6
Change in net unrealized gains and losses on investments	**10**	(24)
Net assets released from restriction	**(35)**	(33)
Other	**–**	7
Increase (decrease) in temporarily restricted net assets	**45**	(11)
Permanently restricted net assets:		
Contributions	**7**	2
Investment income	**1**	–
Change in net unrealized gains and losses on investments	**–**	(1)
Other	**–**	(7)
Increase (decrease) in permanently restricted net assets	**8**	(6)
Increase in net assets	**422**	84
Net assets, beginning of year	**8,076**	7,992
Net assets, end of year	**$ 8,498**	$ 8,076

See accompanying notes.

Sutter Health and Affiliates

Consolidated Statements of Cash Flows

(Dollars in millions)

	Year ended December 31, 2016	2015
Operating activities		
Increase in net assets	**$ 422**	$ 84
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Loss on early extinguishment of debt	**7**	–
Depreciation and amortization	**656**	612
Amortization of bond issuance costs, (premium) and discount, net	**(20)**	(11)
Realized gains and losses and change in net unrealized gains and losses on investments	**(224)**	238
Provision for bad debts	**224**	175
Restricted contributions and investment income	**(78)**	(41)
Loss on impairment of property, plant and equipment	**17**	6
Net gain on disposal of property, plant and equipment	**(22)**	(33)
Change in net postretirement benefits	**109**	121
Net changes in operating assets and liabilities:		
Patient accounts receivable and other receivables	**(469)**	(90)
Inventories and other assets	**20**	(86)
Accounts payable and accrued expenses	**149**	(94)
Other non-current liabilities	**(28)**	17
Net cash provided by operating activities	**763**	898
Investing activities		
Purchases of property, plant and equipment	**(972)**	(898)
Proceeds from disposal of property, plant and equipment	**35**	39
Purchases of investments	**(3,812)**	(2,948)
Proceeds from sales of investments	**3,225**	3,165
Other	**(21)**	(37)
Net cash used in investing activities	**(1,545)**	(679)

Sutter Health and Affiliates

Consolidated Statements of Cash Flows (continued)

(Dollars in millions)

	Year ended December 31, 2016	2015
Financing activities		
Payments of long-term obligations	**$ (50)**	$ (22)
Refund of bonds	**(856)**	(224)
Proceeds from issuance of long-term obligations	**1,343**	194
Bond issuance costs	**(11)**	(3)
Bond issuance premium	**227**	15
Restricted contributions and investment income	**78**	41
Net cash provided by financing activities	**731**	1
Net (decrease) increase in cash and cash equivalents	**(51)**	220
Cash and cash equivalents at beginning of year	**477**	257
Cash and cash equivalents at end of year	**$ 426**	$ 477

See accompanying notes.

1. ORGANIZATION

Sutter Health is a California not-for-profit multi-provider integrated health care delivery system headquartered in Sacramento, California, which includes a centralized support group and various health care-related businesses operating primarily in Northern California. Sutter Health and its affiliates and subsidiaries provide health care, education, research and administrative services.

Sutter Health's integrated health care delivery system includes acute-care, medical foundations, fundraising foundations and a variety of other specialized health care services. These entities are commonly referred to as the affiliates. Most acute-care hospitals provide a full range of medical services (e.g., surgical, intensive care, emergency room, and obstetrics). All emergency rooms provide emergency care, regardless of a patient's ability to pay. Sutter Health and its affiliates also serve their communities with various programs, such as health education, health libraries, school-based clinics, home health care, hospice care, adult day care, prenatal clinics, community clinics, immunization services, and health professions education.

2. ACCOUNTING POLICIES

Basis of Consolidation: The Sutter Health and Affiliates consolidated financial statements include the accounts of Sutter Health and its controlled affiliates and subsidiaries (Sutter). All significant intercompany accounts and transactions have been eliminated in consolidation.

Reclassification: Certain amounts in Sutter's 2015 audited consolidated financial statements have been reclassified to conform to the presentation of its 2016 audited consolidated financial statements. These reclassifications had no impact on previously reported net assets, revenues or income.

Use of Estimates: The preparation of financial statements in conformity with United States (U.S.) Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash Equivalents: Cash equivalents include all highly liquid investments with original maturities of 90 days or less, including money market accounts with limited market risk, and investment-grade debt instruments, many of which are backed by the U.S. Government or other government agencies. Financial instruments that potentially subject Sutter to concentrations of credit risk include cash equivalents and investments. Cash equivalents are stated at fair market value.

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Investments: Investments consist principally of U.S. and foreign equity, corporate and government securities, a multi-strategy hedge fund portfolio and private equity funds, all of which are designated as either trading or other-than-trading and carried at fair market value. Certain investments are held in trust, including assets held by trustees in accordance with the indentures relating to long-term obligations. In addition, certain investments are designated by the appropriate Sutter governing boards for future capital improvements.

Derivative Instruments: Sutter offsets fair value amounts recognized for certain derivative transactions from contracts executed with the same counterparty under a master netting arrangement. As a result, the net exposure to counterparties is reported as an asset or liability in the consolidated balance sheets.

Cost Method Investments: The aggregate carrying amount of all Sutter cost method investments is $24 and $32 as of December 31, 2016 and 2015, respectively. Evaluations for impairment were performed, and $9 was recorded for the year ended December 31, 2016.

Patient Accounts Receivable: Sutter's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed from patients and third-party payers. Sutter manages the receivables by regularly reviewing its patient accounts and contracts and by providing appropriate allowances for uncollectible amounts. These allowances are estimated based upon an evaluation of historical payments, negotiated contracts and governmental reimbursements. Sutter's allowance for doubtful accounts for self-pay patients was 90% and 83% of self-pay accounts receivable at December 31, 2016 and 2015, respectively. Adjustments and changes in estimates are recorded in the period in which they are determined. Significant concentrations of gross patient accounts receivable are as follows:

	December 31,	
	2016	**2015**
Medicare	**31%**	30%
Medi-Cal	**25%**	26%

During 2016 and 2015, certain affiliates collected on accounts that were previously deemed uncollectible and reserved. Such recoveries are recognized in the period that cash is received. Due to the inherent variability in the estimation of future patient receivable collections, there is at least a reasonable possibility that the estimation may change by a material amount in the near term.

2. ACCOUNTING POLICIES (continued)

Inventories: Inventories, which consist principally of medical and other supplies, are stated on the basis of cost determined by the first-in, first-out method, which is not in excess of market.

Property, Plant and Equipment: Property, plant and equipment are stated on the basis of cost, or in the case of donated items, on the basis of fair market value at the date of donation, less depreciation and any impairment write-downs. Equipment includes medical equipment, furniture and fixtures, software, and internally-developed software. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase values, change capacities or extend useful lives are capitalized, as is interest on amounts borrowed to finance constructed assets during the construction phase. Sutter capitalized interest costs of $41 and $49 and accrued obligations for property, plant and equipment of $114 and $78 as of December 31, 2016 and 2015, respectively.

Depreciation is computed by the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years for buildings and improvements, and leasehold improvements, and from 3 to 20 years for equipment. Amortization of equipment under capital leases is included in depreciation and amortization expense.

Asset Impairment: Sutter routinely evaluates the carrying value of its long-lived assets for impairment. The evaluations address the estimated recoverability of the assets' carrying value, which is principally determined based on a qualitative test using the projected net cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds estimated recoverability, asset impairment is recognized.

Other Assets: Goodwill represents the excess of purchase price over the fair market value of net assets acquired. Goodwill and other intangible assets acquired in business combinations that have indefinite useful lives are subject to impairment tests. Sutter performs impairment tests at the reporting unit level annually or when events occur that require an evaluation to be performed. If the carrying value of goodwill is determined to be impaired, or if the carrying value of a business that is to be sold or otherwise disposed of exceeds its fair value, then the carrying value is reduced, including any allocated goodwill, to fair value. Estimates of fair value are based on appraisals, established market prices for comparative assets or internal estimates of future net cash flows based on projected performance, depending on circumstances.

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

In 2015, certain affiliates acquired assets of $48 from six separate purchases, which resulted in an increase to goodwill of $36 and other assets of $13 for the year ended December 31, 2015. Sutter recognized $31 and $4 in revenue and income, respectively, from these operations for the year ended December 31, 2015.

The changes in the carrying amount of goodwill, which are included in Other non-current assets, are as follows:

	Year ended December 31, 2016	2015
Goodwill at beginning of year	**$ 144**	$ 108
Additions	**19**	36
Goodwill at end of year	**$ 163**	$ 144

Other Liabilities: Other non-current liabilities consist of (i) insurance liabilities, including estimated liabilities for professional liability and comprehensive general liability losses, and workers' compensation, (ii) the portion of estimated third-party settlements not expected to be settled within a year, (iii) other postretirement benefits liabilities, and (iv) certain other liabilities.

Risk Management: Sutter Health and most affiliates are insured by a wholly owned self-insured captive insurance company for professional liability claims and comprehensive general liability. Sutter is also self-insured for workers' compensation and employee health for most affiliates.

The provisions for estimated professional liability and comprehensive general liability claims, workers' compensation, and employee health include estimates of the ultimate costs for both uninsured reported claims and claims incurred-but-not-reported, in accordance with actuarial projections or paid claims lag models based on historical experience. Professional liabilities and comprehensive general liabilities were $103 and $103 discounted at a rate of 1.9% and 1.7% as of December 31, 2016 and 2015, respectively. Workers' compensation liabilities were $260 and $248 discounted at a rate of 2.5% and 2.4% as of December 31, 2016 and 2015, respectively. Employee health liabilities were $47 and $45 as of December 31, 2016 and 2015, respectively, and were recorded on an undiscounted basis. Such claim reserves are based on the best data available to Sutter; however, these estimates are subject to a significant degree of inherent variability.

2. ACCOUNTING POLICIES (continued)

There is at least a reasonable possibility that a material change to the estimated reserves will occur in the near term. Such estimates are continually monitored and reviewed, and as reserves are adjusted, the differences are reflected in current operations. Management is of the opinion that the associated liabilities recognized in the accompanying consolidated financial statements are adequate to cover such claims.

Sutter has entered into reinsurance, excess, and stop loss policy agreements with independent insurance companies to limit its losses on professional liability, comprehensive general liability, workers' compensation, and employee health claims.

In lieu of a workers' compensation security deposit requirement, Sutter paid assessment charges to participate in the California Self Insurers' Alternative Security Program, which provided coverage of $269 and $259 as of December 31, 2016 and 2015, respectively.

Asset Retirement and Environmental Obligations: Sutter has recorded an estimated other non-current liability of $45 and $46 at December 31, 2016 and 2015, respectively, related to the fair value of costs for environmental obligations that will result from Sutter's current plans to renovate and/or demolish certain acute-care facilities.

Contingencies: Estimated losses from contingencies are recorded when they are probable and reasonably estimable.

Net Assets: Net resources that are not restricted by donors are included in unrestricted net assets. Gifts of long-lived operating assets, such as property, plant or equipment, are reported as unrestricted net assets and excluded from income. Resources restricted by donors for a specified time or purpose are reported as temporarily restricted net assets.

When the specific purposes are met, either through passage of a stipulated time period or when the purpose for restriction is accomplished, they are released to other operating revenues in the statement of operations and changes in net assets. Resources temporarily restricted by donors for additions to property, plant and equipment are initially reported as temporarily restricted net assets and are transferred to unrestricted net assets when expended. Donor-imposed restrictions, which stipulate that the resources be maintained permanently, are reported as permanently restricted net assets.

Investment income related to temporarily or permanently restricted net assets is classified as either unrestricted, temporarily restricted, or permanently restricted, based on the intent of the donor.

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Patient Service Revenues and Patient Service Revenues less Provision for Bad Debts: Patient service revenues are reported at the estimated net realizable amounts from patients and third-party payers for services rendered, including estimated retroactive adjustments under reimbursement programs with third-party payers. Estimated settlements under third-party reimbursement programs are accrued in the period the related services are rendered and adjusted in future periods, primarily as a result of final cost report settlements with government agencies.

Patient service revenues less provision for bad debts are reported net of the provision for bad debts on the consolidated statement of operations and changes in net assets. Sutter's self-pay write-offs were $204 and $192 for 2016 and 2015, respectively.

Patient services revenues, net of contractual allowances and discounts, are as follows:

	Year ended December 31, 2016	2015
Government	**$ 4,181**	$ 3,604
Contracted	**6,089**	5,879
Self-pay and others	**244**	250
	$ 10,514	$ 9,733

Premium Revenues: Sutter has entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations. The basis for payment to Sutter under these agreements includes capitated arrangements, prospectively determined rates per diagnosis, discounts from established charges, and prospectively determined daily rates.

Sutter also provides health insurance to members of individual and family plans and subscribing employers. Premiums are recognized as revenue in the month in which the member is entitled to receive health care services, net of an allowance for estimated uncollectible amounts, and without regard to services actually performed by Sutter.

Electronic Health Record Incentive Programs: The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act. The provisions were designed to increase the use of electronic health record (EHR) technology and

2. ACCOUNTING POLICIES (continued)

establish the requirements for a Medi-Cal and Medicare incentive payment program beginning in 2011 for eligible providers that adopt and demonstrate meaningful use of certified EHR technology.

Sutter accounts for Medi-Cal and Medicare EHR incentive payments as a gain contingency. For the years ended December 31, 2016 and 2015, Medi-Cal incentives of $3 and $5, and Medicare incentives of $20 and $21, respectively, were recognized in other revenues upon demonstration of compliance with the meaningful use criteria. A portion of the income from incentive payments is subject to retrospective adjustment, as the incentive payments are calculated using Medicare cost report data that is subject to audit. Additionally, Sutter's compliance with meaningful use criteria is subject to audit by the federal government, which could result in changes to amounts previously recorded.

Purchased Services: Purchased services expense is made up of a wide variety of contracted and other purchased services, including medical group compensation, other professional fees, repairs and maintenance, and capitated purchased services. Medical group compensation is accrued by Sutter according to professional services agreements between affiliated medical foundations and contracted medical groups.

Advertising: Sutter expenses advertising costs as incurred. Advertising expense (included in Other expenses) was $24 and $21 for the years ended December 31, 2016 and 2015, respectively.

Research and Development: Sutter expenses research and development costs as incurred. Research and development expense (included in Other expenses) was $41 and $45 for the years ended December 31, 2016 and 2015, respectively.

Income Taxes: Sutter Health, the legal entity, and many affiliates have been determined to be exempt organizations by the Internal Revenue Service and the California Franchise Tax Board, and generally, are not subject to taxes on income. Certain activities of Sutter are subject to income taxes; however, such activities are not significant to the consolidated financial statements. With respect to its taxable activities, Sutter records income taxes using the liability method, under which deferred tax assets and liabilities are determined based on the differences between the financial accounting and tax bases of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the currently enacted tax rate expected to apply to taxable income in the periods that the deferred tax asset or liability is expected to be realized or settled.

2. ACCOUNTING POLICIES (continued)

Sutter recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The statute of limitations for tax years 2013 through 2015 remain open in U.S. tax jurisdictions in which Sutter and its affiliates are subject to taxation. Sutter recognizes interest and penalties related to income tax matters in operating expenses. At December 31, 2016 and 2015, there were no such uncertain tax positions.

Performance Indicator: "Income" and "Income attributable to Sutter Health" as reflected in the accompanying consolidated statements of operations and changes in net assets are performance indicators. The performance indicators include all changes in unrestricted net assets, excluding net assets released from restriction for equipment acquisition, changes in net unrealized gains and losses on investments classified as other-than-trading, and pension-related changes other than net periodic pension cost.

Adoption of New Accounting Pronouncements: In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Sutter is evaluating the impact of this guidance, which will be effective in 2020.

In August and November 2016, the FASB issued ASU Nos. 2016-15 and 2016-18, *Statement of Cash Flows (Topic 230)*. These updates address multiple specific cash flow issues with the objective of reducing the existing diversity in practice. Sutter is evaluating the impact of this guidance, which will be effective in 2018.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new guidance simplifies and improves the face of the financial statements and enhances the disclosures in the footnotes of not-for-profit entities (NFPs). The most significant change is that net assets will now be reported in two classes: net assets without donor restrictions and net assets with donor restrictions. Other simplifications and improvements will be made on how NFPs present information about liquidity, financial performance and cash flows. Sutter is evaluating the impact of this guidance, which will be effective in 2018.

2. ACCOUNTING POLICIES (continued)

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The amendments in this update require lessees to put most leases onto the balance sheet. This guidance aims to increase transparency and comparability among organizations by recognizing lease assets and liabilities and increasing disclosure requirements about leasing arrangements. Sutter is evaluating the potential impact of this guidance, which will be effective for fiscal year 2019.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this update will change how entities measure equity investments that do not result in consolidation and are not accounted for under the equity method and how they present changes in the fair value of financial liabilities measured under the fair value option that are attributable to their own credit. The new guidance also changes certain disclosure requirements and other aspects of current U.S. GAAP. It does not change the guidance for classifying and measuring investments in debt securities. Sutter is evaluating the impact of this guidance, which will be effective in 2018.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede virtually all revenue recognition guidance in U.S. GAAP. The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other U.S. GAAP requirements). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property and equipment, including real estate. The effective date for this standard was delayed with the issuance of ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606).* Sutter is evaluating the potential impact of this guidance, which will be effective in 2018.

(Dollars in millions)

3. INVESTMENTS

Investments are held for the following uses:

	December 31, 2016	December 31, 2015
Assets held in trust:		
Principal, interest and other reserves held in trust under bond indentures	**$ 171**	$ 40
Internally designated	**308**	293
Investments	**4,562**	3,897
	5,041	4,230
Less short-term investments	**(4,374)**	(3,621)
Non-current investments	**$ 667**	$ 609

Investment income includes the following:

	Year ended December 31, 2016	Year ended December 31, 2015
Interest and dividends	**$ 86**	$ 84
Investment fees	**(18)**	(18)
Net realized (loss) gain on sales of securities	**(30)**	26
	38	92
Amounts included in changes in restricted net assets	**(6)**	(6)
Interest earned on unspent bond project funds	**(9)**	(8)
Investment income	**$ 23**	$ 78

Sutter uses the specific identification method to compute realized gains and losses on all investments, except mutual funds, which are computed using the average cost method.

4. FAIR VALUE MEASUREMENTS

Sutter accounts for certain assets at fair value. A fair value hierarchy for valuation inputs has been established to prioritize the valuation inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels, which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices are available in active markets for identical assets as of the measurement date.

Level 2: Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets.

Level 3: Pricing inputs are generally unobservable for the assets and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets. The fair values are therefore determined using factors that involve judgment and interpretations, including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, fund manager estimates and net asset valuations provided by the underlying private investment companies and/or their administrators. Sutter held no Level 3 financial instruments as of December 31, 2016 and 2015.

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

The fair value of Sutter's assets measured on a recurring basis consists of the following:

	December 31, 2016		
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Liquid investments			
Cash equivalents	$ 151	$ –	$ 151
Equity securities			
U.S. equity	1,207	–	1,207
Foreign equity	659	–	659
Fixed income securities			
U.S. government	438	–	438
U.S. government agencies	–	45	45
U.S. state and local government	–	43	43
U.S. federal agency mortgage-backed	–	330	330
Foreign government	–	146	146
U.S. corporate	54	495	549
Foreign corporate	3	170	173
	$ 2,512	$ 1,229	$ 3,741
Investments measured at net asset value			1,300
			$ 5,041

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

	December 31, 2015		
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Liquid investments			
Cash equivalents	$ 194	$ –	$ 194
Equity securities			
U.S. equity	1,182	–	1,182
Foreign equity	596	–	596
Fixed income securities			
U.S. government	256	–	256
U.S. government agencies	–	43	43
U.S. state and local government	–	29	29
U.S. federal agency mortgage-backed	–	313	313
Foreign government	11	169	180
U.S. corporate	48	537	585
Foreign corporate	2	300	302
	$ 2,289	$ 1,391	$ 3,680
Investments measured at net asset value			550
			$ 4,230

There were no transfers to or from Levels 1 or 2 during the periods presented.

4. FAIR VALUE MEASUREMENTS (continued)

As of December 31, 2016 and 2015, the Level 2 instruments listed in the fair value hierarchy tables above use the following valuation techniques and inputs:

U.S. Government Agencies Securities: The fair value of investments in U.S. government agencies securities classified as Level 2 is primarily determined using consensus pricing methods of observable market-based data. Significant observable inputs include quotes, spreads, and data points for yield curves.

U.S. State and Local Government Securities: The fair value of U.S. state and local government securities classified as Level 2 is determined using a market approach. The inputs include yield benchmark curves, prepayment speeds, and observable market data, such as institutional bids, dealer quotes, and two-sided markets.

U.S. Federal Agency Mortgage-backed Securities: The fair value of U.S. federal agency mortgage-backed securities classified as Level 2 is primarily determined using matrices. These matrices utilize observable market data of bonds with similar features, prepayment speeds, credit ratings, and discounted cash flows. Additionally, observed market movements, tranche cash flows and benchmark yields are incorporated in the pricing models.

Foreign Government and Corporate Securities: The fair value of investments in foreign government and corporate securities classified as Level 2 is primarily determined using consensus pricing methods of observable market-based data. Significant observable inputs include quotes, bid and ask yields, and issue-specific factors.

U.S. Corporate Securities: The fair value of investments in U.S. corporate securities classified as Level 2 is primarily determined using techniques that are consistent with the market approach. Significant observable inputs include reported trades, dealer quotes, security-specific characteristics, and multiple sources of spread data points in developing yield curves.

Investments Measured at Net Asset Value (NAV): Certain investments that are measured using the NAV per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The NAV amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

Certain of the investments are reported using a calculated NAV or its equivalent. These investments are not expected to be sold at amounts that are different from NAV. The following table and explanations identify attributes relating to the nature and risk of such investments:

	December 31, 2016			
	Fair Value	**Unfunded Commitments**	**Redemption Frequency (if currently eligible)**	**Redemption Notice Period (if currently eligible)**
Commingled funds – U.S. equity securities	**$ 194**	**$ –**	**Daily**	**1 day**
Commingled funds – foreign equity securities	**118**	**–**	**Monthly**	**10–30 days**
Commingled funds – debt securities	**167**	**–**	**Daily, Monthly**	**15–30 days**
Commodity-linked funds	**47**	**–**	**Monthly**	**5 days**
Multi-strategy hedge fund	**519**	**–**	**Monthly, Quarterly**	**5–197 days**
Private equity funds	**85**	**105**	**None**	**None**
Private equity real estate funds	**170**	**171**	**None**	**None**
Total	**$ 1,300**	**$ 276**		

	December 31, 2015			
	Fair Value	**Unfunded Commitments**	**Redemption Frequency (if currently eligible)**	**Redemption Notice Period (if currently eligible)**
Commingled funds – U.S. equity securities	$ 34	$ –	Daily	1 day
Commingled funds – foreign equity securities	40	–	Monthly	30 days
Commingled funds – debt securities	72	–	Weekly, Monthly	5–15 days
Commodity-linked funds	34	–	Monthly	5 days
Multi-strategy hedge fund	202	–	Monthly, Quarterly	15–197 days
Private equity funds	58	107	None	None
Private equity real estate funds	110	178	None	None
Total	$ 550	$ 285		

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

Commingled Funds – Equity Securities: This class includes investments in commingled funds that invest primarily in U.S. or foreign equity securities and attempt to match the returns of specific equity indices. As of December 31, 2016, approximately 62% of this class is redeemable daily with a 1-day notice period. The remaining 38% of this class is redeemable monthly with a notice period of 10 to 30 days.

Commingled Funds – Debt Securities: This class includes investments in commingled funds that invest primarily in foreign debt, of which the majority are traded in over-the-counter markets. As of December 31, 2016, approximately 38% of the value of this class is redeemable daily, with a notice period of 15 to 30 days. The remaining 62% of this class is redeemable monthly with a 15-day notice period.

Commodity-Linked Funds: This class includes commodity-linked funds that pursue long-only fully collateralized commodity futures strategies to provide diversification and inflation protection. As of December 31, 2016, these funds are redeemable monthly with a 5-day notice before month end.

Multi-Strategy Hedge Fund Portfolio: This class includes investments in hedge funds that expand the universe of potential investment approaches available by employing a variety of strategies and techniques within and across various asset classes. The primary objective for these funds is to balance returns while limiting volatility by allocating capital to external portfolio managers selected for expertise in one or more investment strategies which may include, but are not limited to, equity long/short, event driven, relative value, and directional. The following summarizes the redemption criteria for the multi-strategy hedge fund portfolio as of December 31, 2016:

% of Multi-Strategy Hedge Fund Portfolio	Redemption Criteria	Notice Period
49%	Redeemable monthly	5–75 days
16%	Redeemable quarterly	45–90 days
15%	Limited to a 25% gate, redeemable quarterly	45–197 days
18%	One-year lock-ups periodically expiring through December 2017	60–90 days
2%	Three-year lock-ups expiring in November 2017	65 days

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

Private Equity Funds: This class includes domestic and foreign private equity funds that specialize in providing capital to a variety of investment groups, including but not limited to venture capital, leveraged buyout, mezzanine debt, distressed debt, and other strategies, which may include land, water processing, and alternative energy. There is no provision for redemptions during the life of these funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated, estimated at December 31, 2016, to be over the next 10 to 15 years.

Private Equity Real Estate Funds: This class includes domestic and foreign investments in real estate that are held in limited partnership funds, joint ventures, and other investments comprised of retail, office, industrial, and multi-family properties. There is no provision for redemptions during the life of these funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated, estimated at December 31, 2016, to be over the next 2 to 10 years.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	December 31, 2016	December 31, 2015
Land improvements	**$ 173**	$ 171
Leasehold improvements	**464**	355
Buildings and improvements	**6,797**	6,502
Equipment	**3,846**	3,759
	11,280	10,787
Less amortization and accumulated depreciation	**(5,856)**	(5,429)
	5,424	5,358
Land	**619**	613
Construction-in-progress	**1,692**	1,431
	$ 7,735	$ 7,402

(Dollars in millions)

6. OTHER NON-CURRENT ASSETS

Other non-current assets consist of the following:

	December 31, 2016	2015
Goodwill, net	**$ 163**	$ 144
Trust receivable	**90**	98
Reinsurance recoveries receivable	**72**	70
Non-current portion of pledges receivable	**33**	31
Other	**70**	98
	$ 428	$ 441

7. LONG-TERM OBLIGATIONS

Long-term obligations consist of the following:

	December 31, 2016	2015
Non-taxable hospital revenue bonds and certificates of participation under the Sutter Health Master Indenture of Trust, fixed interest at 1.0% to 6.0%, through 2052 (includes net unamortized premiums and discounts of $269 and $67 and debt issuance costs of ($23) and ($17) at December 31, 2016 and 2015, respectively)	**$ 4,094**	$ 3,374
Taxable hospital revenue bonds and certificates of participation under the Sutter Health Master Indenture of Trust, fixed interest at 1.67% to 2.29%, through 2020	**200**	300
Various collateralized and unsecured obligations	**37**	26
Obligations under capital leases	**8**	8
	4,339	3,708
Less current portion	**(201)**	(49)
	$ 4,138	$ 3,659

7. LONG-TERM OBLIGATIONS (continued)

The aggregate estimated fair market values of Sutter's revenue bonds and certificates of participation at December 31, 2016 and 2015, of $4,309 and $3,876, respectively, were established using discounted cash flow analyses based on (i) the current market yield to maturity for similar types of publicly traded debt issues, and (ii) Sutter's current incremental borrowing rates for all other debt instruments. Based on the inputs and valuation techniques, the fair value of long-term debt is classified as Level 2 within the fair value hierarchy.

The central financing vehicle of credit for Sutter is the Obligated Group. Sutter Health, the legal entity, and certain affiliates are members of the Sutter Health Obligated Group (the "Obligated Group"), with their assets being subject to the indebtedness of the Obligated Group. Although the Obligated Group is not a legal entity, members of the Obligated Group are jointly and severally liable for repayment of the tax-exempt obligations issued through the California Health Facilities Financing Authority (CHFFA), California Statewide Communities Development Authority (CSCDA) and taxable obligations issued by Sutter. The related financing documents and various other debt agreements contain certain restrictive covenants requiring compliance by all members, including a pledge of gross revenue.

In November 2015, $189 of Series 2015A CHFFA tax-exempt revenue bonds were issued on behalf of Sutter. The proceeds of the bonds, together with the release of the Series 2005A CSCDA Reserve Account, were used to refund $224 of Series 2005A CSCDA revenue bonds. The refund did not result in a gain or loss.

In February 2016, $475 of Series 2016A CHFFA tax-exempt revenue bonds were issued on behalf of Sutter. The proceeds of the bonds were used to reimburse prior capital expenditures.

In August 2016, $100 of Series 2013A Sutter Health taxable revenue bonds were redeemed, which did not result in a gain or loss.

In August 2016, $749 of Series 2016B CHFFA tax-exempt revenue bonds were issued on behalf of Sutter to refund outstanding amounts of the Series 2007A CHFFA tax-exempt revenue bonds and the Series 2005BC and Series 2003AB CSCDA tax-exempt revenue bonds (the "Refunded Bonds"). The proceeds of the Series 2016B bonds, together with the release of certain funds related to the Refunded Bonds, were placed in an irrevocable trust to pay the bonds at the time of redemption. The Series 2007A bonds of $756 were legally defeased and derecognized at the date of refunding with the redemption occurring in

(Dollars in millions)

7. LONG-TERM OBLIGATIONS (continued)

November 2016, and Other expenses includes $7 for the loss on early extinguishment of debt. As of December 31, 2016, Short-term investments includes $148 for the redemption of the Series 2005BC bonds of $47 and the Series 2003AB bonds of $96, which are considered an advanced refunding, and the associated debt is included in the current portion of long-term obligations with redemptions in 2017.

In August 2016, $100 of Series 2016C CHFFA tax-exempt revenue bonds were issued on behalf of Sutter. The proceeds of the Series 2016C bonds were used to reimburse prior capital expenditures.

Aggregate principal payments of long-term obligations, excluding capital leases, various collateralized and unsecured obligations, net unamortized premiums, and issuance costs as of December 31, 2016 are as follows:

2017	$ 188
2018	43
2019	46
2020	48
2021	55
Thereafter	3,668
	$ 4,048

Sutter paid interest of $126 and $122 for the years ended December 31, 2016 and 2015, respectively.

Sutter has a $400 revolving line of credit with a syndicate of banks, with $400 available for borrowing as of December 31, 2016.

8. LEASES

Sutter leases various buildings, office space and equipment. The leases expire at various times and contain certain contingent rental provisions, guarantees and various renewal options. These leases are classified as either capital leases, which were not material as of December 31, 2016 and 2015, or operating leases, based on the terms of the respective agreements.

(Dollars in millions)

8. LEASES (continued)

Future minimum payments, by year and in the aggregate, under noncancellable operating leases with terms of one year or more at inception consist of the following as of December 31, 2016:

	Lease Payments	Sublease Receipts	Net Lease Payments
2017	$ 144	$ 9	$ 135
2018	117	3	114
2019	93	1	92
2020	71	–	71
2021	63	–	63
Thereafter	261	–	261
	$ 749	$ 13	$ 736

9. NET ASSETS AND CONTRIBUTIONS

Sutter receives donations through its philanthropic affiliates from the generosity of donors supporting certain programs and services. Donations with a restriction included in temporarily and permanently restricted net assets were maintained for the following purposes:

	December 31, 2016	December 31, 2015
Temporarily restricted:		
Capital projects and medical equipment	**$ 48**	$ 48
Time restricted under trust agreements	**20**	23
Research and education	**79**	63
Operations	**21**	29
Operations or capital projects	**128**	88
	$ 296	$ 251
Permanently restricted – endowment	**$ 144**	$ 136

Unconditional promises to give cash or other assets are reported at fair market value at the date the promises are received. Conditional promises to give and indications of intentions to give are reported at fair market value when the conditions are met. Therefore, no revenue or receivable is recognized at the time a conditional promise is received. Conditional promises were not material as of December 31, 2016 and 2015.

(Dollars in millions)

9. NET ASSETS AND CONTRIBUTIONS (continued)

As of December 31, 2016, pledges receivable (included in Other receivables and Other non-current assets) consisted of the following unconditional promises to give:

Pledges due in 2017	$	10
Pledges due 2018–2021		32
Pledges due after 2021		9
Less allowance for uncollectible pledges		(2)
Less discount on pledges receivable		(7)
	$	42

Endowments: Sutter follows the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA eliminates the concept of “historic dollar value” and allows an institution to spend or accumulate as the board determines is prudent for the uses, benefits, purposes, and duration of the endowment fund unless the gift instrument states a particular spending rate or formula. California’s version of UPMIFA also includes a rebuttable provision that spending greater than 7% of the average fair market value (calculated at least quarterly over a minimal period of three years) is presumed to be imprudent.

In accordance with UPMIFA, Sutter considers the following factors when appropriating or accumulating an endowment fund: (i) general economic conditions, (ii) effects of inflation and deflation, (iii) the purposes of the institution and the endowment fund, (iv) expected total return from income and appreciation of investments, (v) Sutter’s other resources, (vi) the duration and preservation of the endowment fund, and (vii) Sutter’s investment policies.

From time to time, the fair value of assets associated with individual endowment funds may fall below the level that the donor or UPMIFA requires Sutter to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were not material as of December 31, 2016 and 2015. These deficiencies resulted from unfavorable investment market fluctuations.

Sutter has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under these policies, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results while assuming a moderate level of investment risk.

(Dollars in millions)

9. NET ASSETS AND CONTRIBUTIONS (continued)

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

The endowment net asset composition by type of fund consists of the following:

	December 31, 2016			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Donor-restricted endowment funds	**$ –**	**$ 34**	**$ 144**	**$ 178**
Board-designated funds	**74**	**–**	**–**	**74**
Total funds	**$ 74**	**$ 34**	**$ 144**	**$ 252**

	December 31, 2015			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Donor-restricted endowment funds	$ –	$ 29	$ 136	$ 165
Board-designated funds	73	–	–	73
Total funds	$ 73	$ 29	$ 136	$ 238

(Dollars in millions)

9. NET ASSETS AND CONTRIBUTIONS (continued)

The changes in endowment net assets are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance at December 31, 2014	$ 72	$ 44	$ 142	$ 258
Investment return:				
Investment income	1	3	–	4
Net loss – realized and unrealized	(4)	(17)	(1)	(22)
Total investment loss	(3)	(14)	(1)	(18)
Contributions	3	–	2	5
Appropriation of endowment assets for expenditure	(1)	(3)	–	(4)
Other	2	2	(7)	(3)
Balance at December 31, 2015	73	29	136	238
Investment return:				
Investment income	**1**	**3**	**–**	**4**
Net gain – realized and unrealized	**3**	**9**	**1**	**13**
Total investment return	**4**	**12**	**1**	**17**
Contributions	**–**	**–**	**7**	**7**
Appropriation of endowment assets for expenditure	**(1)**	**(7)**	**–**	**(8)**
Other	**(2)**	**–**	**–**	**(2)**
Balance at December 31, 2016	**$ 74**	**$ 34**	**$ 144**	**$ 252**

10. PATIENT SERVICE REVENUES

Sutter has agreements with third-party payers that provide for payments to Sutter at amounts different from its established rates. Sutter is reimbursed for services provided to its patients under a variety of contracted agreements or other payment methodologies. Amounts received from the Medicare and Medi-Cal programs are subject to review and final determination by a Medicare Administrative Contractor (MAC). Sutter's Medicare cost reports have been audited by MAC generally through December 31, 2013. The estimated net settlement payables are $25 and $15 at December 31, 2016 and 2015, respectively. Sutter's Medi-Cal cost reports have been audited generally through December 31, 2012. The estimated net settlement payables are $4 and $16 at December 31, 2016 and 2015, respectively.

(Dollars in millions)

10. PATIENT SERVICE REVENUES (continued)

Adjustments from the finalization of prior-year cost reports from both Medicare and Medi-Cal resulted in an increase to patient service revenues of $20 and a decrease to patient service revenues of $19 for the years ended December 31, 2016 and 2015, respectively.

Gross patient charges, including charges related to capitated patients, from the Medicare and Medi-Cal programs accounted for the following percentages of Sutter's gross patient service revenues:

	Year ended December 31,	
	2016	**2015**
Medicare	**41%**	40%
Medi-Cal	**19%**	20%

The health care industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement laws and regulations, anti-kickback and anti-referral laws and false claims prohibitions, and in the case of tax-exempt hospitals, the requirements of tax exemption. In recent years, government activity has increased with respect to investigations and allegations concerning possible violations of reimbursement, false claims, anti-kickback and anti-referral statutes and regulations by health care providers. Sutter operates an Ethics and Compliance Program, which reviews compliance with government health care program requirements and investigates allegations of non-compliance received from internal and external sources. From time to time, findings may result in repayment of monies previously received from government payers and/or disclosure of such overpayments, including, but not limited to, disclosure to the Centers for Medicare and Medicaid Services (CMS) and its contracted agents, or the Office of Inspector General, Department of Health and Human Services. As a result, there is at least a reasonable possibility that the recorded estimates may change by a material amount in the near term.

The State of California enacted legislation for a hospital fee program to fund certain Medi-Cal coverage expansions. The program obtains federal matching funds for Medi-Cal with the proceeds redistributed to California hospitals to treat Medi-Cal patients. In October 2013, a 36-month hospital fee program was established for the period from January 1, 2014 through December 31, 2016. The fee-for-service component was approved in 2014, six

(Dollars in millions)

10. PATIENT SERVICE REVENUES (continued)

months of the managed care non-expansion component was approved in 2015 and twelve months of the managed care expansion and non-expansion components were approved in 2016.

Patient service revenues and Other expenses include amounts for the hospital fee program as follows:

	Year ended December 31,	
	2016	**2015**
Hospital fee program revenue	**$ 563**	$ 382
Hospital fee program expense	**(341)**	(269)
Income from operations from hospital fee program	**$ 222**	$ 113

	December 31,	
	2016	**2015**
Other receivables	**$ 319**	$ 127
Accounts payable	**$ 70**	$ 63

11. COMMUNITY BENEFIT EXPENSE

Services for the poor and underserved include traditional charity care, which covers health care services provided to persons who meet certain criteria and cannot afford to pay, as well as the unpaid costs of public programs treating Medi-Cal and indigent beneficiaries. Costs are computed based on a relationship of costs to charges. Services for the poor and underserved also include the cost of other services provided to persons who cannot afford health care because of inadequate resources and are uninsured or underinsured, and cash donations on behalf of the poor and needy. Sutter provided charity care services to patients at an estimated cost of $51 and $52 for 2016 and 2015, respectively. Estimated costs are based on a ratio of medical costs to related charges.

Benefits for the broader community include costs of providing the following services: health screenings and other health-related services, training health professionals, educating the community with various seminars and classes, the cost of performing medical research, and the costs associated with providing free clinics and community services. Benefits for the broader community also include contributions Sutter makes to community agencies to fund charitable activities.

(Dollars in millions)

11. COMMUNITY BENEFIT EXPENSE (continued)

The following is a summary of Sutter's estimated costs of providing services to the poor and broader community for the year ended December 31, 2016 (unaudited):

Services for the poor and underserved	
Traditional charity care	$ 51
Unpaid costs of public programs:	
Medi-Cal	388
Other public programs	46
Other benefits for the poor and underserved	52
Total services for the poor and underserved	537
Benefits for the broader community	
Nonbilled services	39
Education and research	63
Cash and in-kind donations	28
Other community benefits	2
Total benefits for the broader community	132
	$ 669

12. POSTRETIREMENT BENEFITS

Sutter sponsors and participates in various employee benefit plans, including a noncontributory defined benefit plan (the "Retirement Plan") and several contributory defined contribution plans. Sutter's total retirement benefit expense was $307 and $297 in 2016 and 2015, respectively.

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

Sutter's measurement date for plan assets, pension obligations and net periodic pension cost associated with the Retirement Plan is December 31. The changes in benefit obligations and plan assets for the Retirement Plan are as follows:

	Year ended December 31,	
	2016	**2015**
Projected benefit obligation at beginning of year	**$ 3,346**	$ 3,334
Service cost	**218**	237
Interest cost	**162**	146
Actuarial loss (gain)	**226**	(258)
Benefits paid	**(127)**	(113)
Projected benefit obligation at measurement date	**$ 3,825**	$ 3,346
Fair value of plan assets at beginning of year	**$ 3,099**	$ 3,206
Actual gain (loss) on plan assets	**188**	(94)
Employer contributions	**300**	100
Benefits paid	**(127)**	(113)
Fair value of plan assets at measurement date	**$ 3,460**	$ 3,099
Net accrued benefit cost at end of year	**$ (365)**	$ (247)

The accumulated benefit obligation for the Retirement Plan was $3,363 and $2,957 at December 31, 2016 and 2015, respectively.

Unrecognized actuarial losses of $1,046 and $831 are included in net assets at December 31, 2016 and 2015, respectively, and $66 is expected to be recognized in net periodic benefit cost during the year ended December 31, 2017.

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

The benefits expected to be paid from the Retirement Plan in each of the next five years, and in the aggregate for the next five years, are as follows:

2017	$	131
2018		146
2019		165
2020		181
2021		203
2022–2026		1,247
	$	2,073

The actuarial assumptions used by the Retirement Plan are as follows:

	December 31,	
	2016	**2015**
Weighted-average discount rates for calculating pension expense	**4.6%**	4.2%
Weighted-average discount rates for calculating projected benefit obligation	**4.3%**	4.6%
Weighted-average rates of compensation increase for calculating pension expense	**4.0%**	4.0%
Weighted-average rates of compensation increase for calculating projected benefit obligation	**4.0%**	4.0%
Expected long-term rates of return on plan assets for calculating pension expense	**7.6%**	7.7%

As of December 31, 2016 and 2015, the healthy mortality assumption reflected Table RP2014 (adjusted back to 2006), with the mortality projection using the Scale MP2015 with adjustments to the long-term rate of improvement at 0.75% grading down to 0.00% from age 85 to 115 and a 10-year convergence period from 2010 to 2020.

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

The components of the Retirement Plan's net periodic benefit cost are as follows:

	Year ended December 31, 2016	2015
Service cost	**$ 218**	$ 237
Interest cost	**162**	146
Expected return on plan assets	**(230)**	(243)
Amortization of prior service cost	**–**	2
Amortization of actuarial loss	**52**	50
	$ 202	$ 192

In addition to the Retirement Plan, Sutter also has noncontributory postretirement health benefit plans (the "Health Plans"). Sutter's measurement date for plan assets, retiree medical obligations and net periodic retiree medical cost associated with the Health Plans is December 31. The changes in benefit obligations for the Health Plans are as follows:

	Year ended December 31, 2016	2015
Projected benefit obligation at beginning of year	**$ 241**	$ 237
Service cost	**11**	12
Interest cost	**10**	9
Actuarial loss (gain)	**1**	(16)
Other change in benefit obligation	**–**	9
Benefits paid	**(10)**	(10)
Projected benefit obligation at measurement date	**$ 253**	$ 241
Fair value of plan assets at beginning of year	**$ 154**	$ 152
Actual gain (loss) on plan assets	**11**	(4)
Employer contributions	**20**	16
Benefits paid	**(10)**	(10)
Fair value of plan assets at measurement date	**$ 175**	$ 154
Net accrued benefit cost at end of year	**$ (78)**	$ (87)

An additional contribution to the Health Plans was made in February 2017 for the 2016 plan year of $20.

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

Included in net assets at December 31, 2016 and 2015, are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized prior service costs of $7 and $10, respectively, and unrecognized actuarial loss of $15 and $14, respectively. The amounts included in net assets that are expected to be recognized in net periodic benefit cost during the year ended December 31, 2017, are $1 for prior service cost and $0 for actuarial gain.

The benefits expected to be paid from the Health Plans in each of the next five years, and in the aggregate for the next five years, are as follows:

2017	$ 16
2018	18
2019	20
2020	21
2021	22
2022–2026	113
	$ 210

The actuarial assumptions used by the Health Plans are as follows:

	December 31, 2016	December 31, 2015
Weighted-average discount rates for calculating retiree medical expense	**4.2%–4.5%**	3.8%–4.1%
Weighted-average discount rates for calculating projected benefit obligation	**3.9%–4.2%**	4.2%–4.5%
Expected long-term rates of return on plan assets for calculating retiree medical expense	**7.6%**	7.7%

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

The components of the Health Plans' net periodic benefit cost are as follows:

	Year ended December 31, 2016	2015
Service cost	**$ 11**	$ 12
Interest cost	**10**	9
Expected return on plan assets	**(12)**	(12)
Amortization of prior service cost	**2**	3
Other	**1**	1
	$ 12	$ 13

Sutter's projected medical cost trend rate related to the Health Plans for 2017 is 6.0%. The assumed medical cost trend rate is expected to gradually decrease in subsequent years to 4.8% in 2023 and thereafter. A one-percentage-point change in assumed health care cost trend rates would not have a material effect on Sutter's consolidated financial statements.

The Pension and Investment Committee (PIC) of the Board of Directors oversees the assets of the Retirement Plan and the Health Plans. Effective February 4, 2016, the PIC dissolved. Effective May 5, 2016, the Sutter Health Board of Directors approved a new governance committee, the Retirement Benefits Investment Committee, that oversees the investments and investment policy of the plans. Management of the assets is governed by the application of modern portfolio theory, resulting in asset class diversification and mean-variance optimization. Sutter's investment strategy is to balance the liquidity needs of the plans with the long-term return goals necessary to satisfy future obligations.

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

The target asset allocation seeks to reduce volatility while capturing the equity premium from the capital markets over the long term and maintaining security of principal to meet near-term expenses and obligations. The target asset allocation at December 31, 2016, by major asset category is as follows:

Major Asset Category	Target Allocation 2016
Equity securities	55%
Fixed income securities	15%
Other investments – alternative	20%
Real estate investments	10%
Total	100%

Equity securities are comprised of U.S. and foreign equity securities, common and collective trusts, and commingled funds. The equity securities' target asset allocation of 55% is further comprised of 24% domestic large capitalization, 6% domestic small capitalization and 25% international/global.

The portfolio return assumption of 7.6% and 7.7% for 2016 and 2015, respectively, was based on the weighted-average return of comparative market indices for the major asset classes represented in the portfolio, net of administrative expenses.

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

A fair value hierarchy has been established, with three levels that prioritize the valuation inputs into each level (see Note 4). The fair value and NAV of the Retirement Plan's and the Health Plans' assets measured on a recurring basis consist of the following:

	December 31, 2016			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Net Asset Value (NAV)**	**Total**
Liquid investments:				
Cash equivalents	$ 50	$ –	$ 116	$ 166
Equity securities:				
U.S. equity	870	–	–	870
Foreign equity	772	–	–	772
Common collective trusts and commingled funds	–	–	784	784
Fixed income securities:				
U.S. government and agencies	88	4	–	92
U.S. federal agency mortgage-backed	–	81	–	81
Foreign government	–	113	–	113
U.S. corporate	–	108	–	108
Foreign corporate	–	38	–	38
Other investments:				
Private equity funds	–	–	253	253
Private equity real estate funds	–	–	284	284
Commodity-linked funds	–	–	69	69
Accrued income	5	–	–	5
Total Retirement Plan and Health Plan assets	$ 1,785	$ 344	$ 1,506	$ 3,635

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

	December 31, 2015			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Net Asset Value (NAV)	Total
Liquid investments:				
Cash equivalents	$ 51	$ –	$ 63	$ 114
Equity securities:				
U.S. equity	932	–	–	932
Foreign equity	828	–	14	842
Common collective trusts and commingled funds	–	–	302	302
Fixed income securities:				
U.S. government and agencies	80	9	–	89
U.S. federal agency mortgage-backed	–	76	–	76
Foreign government	5	132	–	137
U.S. corporate	–	142	–	142
Foreign corporate	–	79	–	79
Other investments:				
Private equity funds	–	–	237	237
Private equity real estate funds	–	–	244	244
Commodity-linked funds	–	–	53	53
Accrued income	6	–	–	6
Total Retirement Plan and Health Plan assets	$ 1,902	$ 438	$ 913	$ 3,253

There were no transfers to or from Levels 1 or 2 during the years presented.

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

Certain affiliates participate in multiemployer defined benefit retirement plans as described below:

Plan	Pension Plan Employer Identification Number/Plan Number	Pension Protection Act Zone Status As of January 1, 2016	Pension Protection Act Zone Status As of January 1, 2015	Funding Improvement/ Rehabilitation Plan
Retirement Plan for Hospital Employees	94-2995676/001	**Green**	Green	N/A
I.U.O.E Stationary Engineers Local 39 Pension Plan	94-6118939/001	**Green**	Green	Implemented

Pension Protection Act Zone Status (from worst to best):

Critical Status	Red
Seriously Endangered	Orange
Endangered	Yellow
None of the above	Green

Plan	Contributions 2017 (expected)	Contributions 2016	Contributions 2015	Surcharge Imposed (during 2016)	Collective Bargaining Agreement Expiration Date	Contributions to Plan Exceeded More than 5% of Total Contributions
Retirement Plan for Hospital Employees	$ 18	**$ 19**	$ 24	No	April 30, 2020, or prior	2016 and 2015
I.U.O.E Stationary Engineers Local 39 Pension Plan	Not Available	**3**	3	No	January 31, 2022, or prior	No
Total contributions		**$ 22**	$ 27			

(Dollars in millions)

12. POSTRETIREMENT BENEFITS (continued)

For the two participating affiliates in the Retirement Plan for Hospital Employees, participant benefits were frozen for the non-contractual employees on January 1, 2011, and for the contractual employees on January 1, 2014. Both affiliates will continue to make periodic contributions as needed for eligible participants.

There are no minimum contributions required for future periods by the collective-bargaining agreements, statutory obligations, or other contractual obligations for both plans.

The risks of participating in multiemployer plans are different from single-employer plans in the following aspects: (i) assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers, (ii) if a participating employer stops contributing to the plan, the unfunded obligations of, the plan may be borne by the remaining participating employers, and (iii) if the affiliates choose to stop participating in the multiemployer plan, the affiliates may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

Sutter also maintains various defined contribution plans for eligible employees. Sutter's contributions to such plans were $71 and $65 in 2016 and 2015, respectively.

13. FUNCTIONAL CLASSIFICATION OF EXPENSES

The following is a functional classification of Sutter's expenses:

	Year ended December 31, 2016	2015
Health services	**$ 10,376**	$ 9,645
General and administrative	**1,127**	1,066
	$ 11,503	$ 10,711

14. CONTINGENCIES AND COMMITMENTS

Contingencies: In January 2007, a class action complaint was filed against Sutter alleging lack of accessibility to Sutter facilities for people with disabilities. In 2008, Sutter entered into a settlement agreement with the plaintiffs. The settlement agreement provides for an implementation period of ten years, ending July 2018. The settlement terms address: (i) correction to certain physical barriers that may limit a disabled person's access to facilities, (ii) modification to or purchase of medical equipment to provide improved accessibility to medical equipment, and (iii) adoption of new policies and procedures to improve access to facilities. Assessment of physical barriers and potential modification is currently in progress and is expected to continue for several years. It is difficult to estimate the cost of these proposed modifications. There can be no assurance that the resolution of these matters will not have a material adverse effect on Sutter's consolidated financial position or results of operations.

As a part of its compliance activities, Sutter performed an internal compliance audit related to certain physician arrangements of certain affiliates. Sutter elected to make voluntary self-disclosures to the federal government (in accordance with federal self-disclosure guidelines) related to certain physician financial arrangements that may constitute potential violations of federal regulatory standards. These disclosures were made in October and November 2010, November 2011, January 2014, and October 2014. A supplemental to the disclosure was later submitted in October 2016. The resolution of this matter is currently on hold as there is potential overlap with the regulatory investigation noted below. In February 2015, Sutter received notification of a regulatory investigation regarding certain physician financial arrangements. The investigation spans a timeframe beginning in January 2006 through the present. The investigation is in its early stages and no final conclusions can be reached. The investigation could include payments to the government and/or the imposition of additional compliance requirements. At this time, management cannot estimate the amounts of any payments or settlements that may result, or whether additional, related matters may arise. There can be no assurance that the resolution of this investigation will not have a material adverse effect on Sutter's consolidated financial position or results of operations.

In recent years, government activity has increased with respect to investigations and allegations concerning possible violations of reimbursement, false claims, anti-kickback and anti-referral statutes, and regulations by health care providers. Certain Sutter affiliates have received, and are in the process of responding to, requests from governmental agencies, including the Department of Justice, the California Attorney General, the California Department of Public Health and the Office of Civil Rights. Sutter is also involved in other litigation, as both plaintiff and defendant, and other routine labor matters,

14. CONTINGENCIES AND COMMITMENTS (continued)

class-action complaints, tax examinations, security events resulting in potential privacy incidents, and regulatory investigations and examinations arising in the ordinary course of business. There can be no assurance that the resolution of these matters will not have a material adverse effect on Sutter's consolidated financial position or results of operations.

As of December 31, 2016, Sutter had approximately 53,000 employees, of whom approximately 33,000 are full-time employees. Approximately 25% of these 53,000 employees are represented by collective bargaining units. Employee strikes or other adverse labor actions may have a material adverse impact on Sutter's consolidated financial position or results of operations.

Commitments: Sutter is required to remediate certain of its health care facilities to comply with earthquake retrofit requirements under a State of California law. Most of Sutter's facilities are compliant or have received extensions, making the facilities compliant until 2030, and Sutter is evaluating its facilities and is considering all options. On July 9, 2013, the City and County of San Francisco (CCSF) approved two projects proposed by Sutter Bay Hospitals (SBH), doing business as California Pacific Medical Center (CPMC). Pursuant to these approvals, SBH is building a new hospital at Van Ness and Geary and a new hospital at a site adjacent to the St. Luke's hospital in San Francisco. As a condition of obtaining approval of the projects, SBH entered into a development agreement with CCSF that obligated SBH to pay the aggregate sum of $85, which is generally payable in installments beginning in 2013 and ending in 2017, with a remaining commitment of $7 as of December 31, 2016. The remaining estimated cost of development and construction is approximately $1,342 (unaudited) for these two facilities, parking garages, and tenant improvements associated with a new medical office building adjacent to the new hospital at Van Ness and Geary.

Sutter's capital allocation plan, which includes amounts for seismic retrofits, replacement facilities, relocations and expansion is approximately $3,796 (unaudited) from January 1, 2017 to December 31, 2021. Management and the Board of Directors evaluate Sutter's capital needs on an ongoing basis.

15. SUBSEQUENT EVENTS

Sutter has evaluated subsequent events and disclosed all material events through March 7, 2017, which is the date these consolidated financial statements were issued.