Date: 8-30-2018

To: State Board Staff

From: John D. Glover, Chief Operating Officer, Franciscan Ministries

Re: CON Application #18-028, Village at Mercy Creek

The following represent responses to your preliminary findings for the above mentioned CON application:

1. To clarify, our proposal is for one 40-bed skilled nursing facility. The building will be divided into two neighborhoods but is one facility with one address. Please see ADDENDUM 1 for a modified drawing of the proposed site.

2. We have modified Page 2 of the application, indicating that both the Franciscan Sisters of Chicago Service Corporation and the Village at Mercy Creek are Co-Applicants. As such, ADDENDUM 2 includes a modified Page 2 and an attestation by Judy Amiano, the CEO and President of Franciscan Ministries, that FSCSC will guarantee the loan for the proposed project. ADDENDUM 3 includes the audited financial statements for the Franciscan Sisters of Chicago Service Corporation (FSCSC) for the three most recent fiscal years as well as the FSCSC pro forma with the Village at Mercy Creek, projecting the first full year after achieving stabilized occupancy of the project.

3. Included as ADDENDUM 4 is a Certificate of Good Standing for the Village at Mercy Creek. ADDENDUM 5 provides projected information for the Village at Mercy Creek for the first year after project completion. As the skilled nursing facility has not been built yet, historic financial information for the proposed site is not available.

4. To further expand on the Purpose of the Project section of the application, a skilled nursing facility is being proposed in this HSA due to current need. ADDENDUM 6 includes an excerpt from the Asset Purchase Agreement of the existing SNF in Chenoa, Illinois, outlining the discontinuation of 40 of its beds as well as an excerpt from the sponsorship agreement, transferring these 40 beds to the new project. Following is a list of problems/issues the proposed project will address:

**Problem 1:** Within the PMA, there is a substantial deficit in access to quality healthcare. The market as it stands has 1,227 operational skilled beds in service. Of the 1,227 skilled beds, 81% (approximately 994 beds) are housed in skilled facilities that operate at or below a 2-star CMS rating.

**Problem 2:** Within the PMA, 99% of all beds in service exist in facilities in excess of 35 years of age.

| Facility Name | Distance | Facility Age | Star Rating | # of Beds | % of Market Share |
|---|---|---|---|---|---|
| Aperion Care | 2.1 | 40 | 1 | 117 | 10% |
| Bloomington Rehab | 3.5 | 48 | 1 | 78 | 6% |
| Heartland of Normal | 0.7 | 48 | 2 | 116 | 9% |
| Heritage of Bloomington | 2.4 | 54 | 5 | 111 | 9% |
| Heritage of El Paso | 19 | 45 | 5 | 65 | 5% |
| Heritage of Normal | 0.7 | 38 | 2 | 141 | 11% |
| Leroy Manor | 20.5 | 38 | 2 | 102 | 8% |
| Luther Oaks | 6.1 | 11 | NR | 18 | 1% |
| McClean County | 0.8 | 48 | 3 | 150 | 12% |
| Meadows Mennonite | 23.4 | 95 | 2 | 116 | 9% |
| St. Joseph Medical Center | 3.6 | 5 | 5 | 12 | 0% |
| Westminster Village | 4.5 | 40 | 4 | 78 | 6% |
| El Paso Health Care Center | 19.6 | 40 | 2 | 123 | 10% |

**Problem 3**: Within the PMA, both of the primary referring hospitals experience readmission rates (20.28%) in excess of their targeted range in the seven diagnoses monitored by CMS.

**Problem 4**: Within the PMA, the target demographic (ages 75-85+) is expected to experience population growth by 1.2% by 2020 and 4.7% by 2030.

Population by Age

| Age | 2015 | 2020 | 2025 | 2030 | 2035 |
|---|---|---|---|---|---|
| 65-69 | 6,863 | 8,664 | 9,479 | 9,462 | 8,482 |
| 70-74 | 4,753 | 6,357 | 7,813 | 8,525 | 8,484 |
| 75-79 | 3,369 | 4,144 | 5,700 | 6,995 | 7,629 |
| 80-84 | 2,476 | 2,617 | 3,248 | 4,460 | 5,489 |
| 85+ | 2,911 | 2,931 | 3,113 | 3,635 | 4,489 |

Projected Population Average Annual Rate of Change

| Age/Year | 2015-2020 | 2020-2025 | 2025-2030 | 2030-2035 |
|---|---|---|---|---|
| 65-69 | 5.2% | 1.9% | 0.0% | -2.1% |
| 70-74 | 6.7% | 4.6% | 1.8% | -0.1% |
| 75-79 | 4.6% | 7.5% | 4.5% | 1.8% |
| 80-84 | 1.1% | 4.8% | 7.5% | 4.6% |
| 85+ | 0.1% | 1.2% | 3.4% | 4.7% |

The combination of these four conditions has not created a medically driven financial or healthcare crisis yet; however, as the trend increases of patients admitting to healthcare centers with more complex diagnoses and co-morbidities, along with a projected increase in the population (target demographic), the potential for a crisis to surface is likely.

5. a. A joint venture with the Mennonite Meadows Retirement Communities was not considered because this entity is in the process of selling all their assets and had no interest in future involvement or partnership.

   b. Utilizing other providers was not considered because Franciscan Ministries has the financial bench strength to operate the proposed project on its own. That being said, the skilled nursing facility will be pursuing other partners to assist in providing the highest quality care possible to its patients, both during their stay and following discharge. These partners will include various home and community-based services, hospice providers, palliative care programs and/or community health centers.

   c. The reasons why this alternative was chosen were delineated in the original application narrative. They include:

   - Few private beds exist in in the identified skilled nursing competitors in this market area. The proposed project would address this shortage by providing its patients with all private rooms which would enhance resident dignity.
   - Few skilled nursing competitors in this market area have a CMS star rating of four stars and above. The proposed project would offer a state-of-the-art nursing facility that provides an overall quality-driven patient experience. (Please note that every skilled nursing facility that Franciscan Ministries owns in Illinois has a CMS star rating of five stars.)

- The proposed health care center would be designed as a transitional unit for the consumer looking for a short-term stay, whether it be rehab to home or remediation of medically complex issues, such as CHF (chronic heart failure), pneumonia or COPD (chronic obstructive pulmonary disorder). The facility would appeal to both residents already living on campus as well as the senior population from the surrounding community.
- The proposed project would be a faith-based ministry and as such, would continue to promote and support the mission of the legacy sponsor, the Mennonite Retirement Communities. Franciscan Ministries, a Catholic organization, would work to enmesh its values with those of the Mennonites to provide a Christian environment with a strong spiritual base. It should be noted that currently, very few skilled providers with religious affiliations exist in the defined market area.

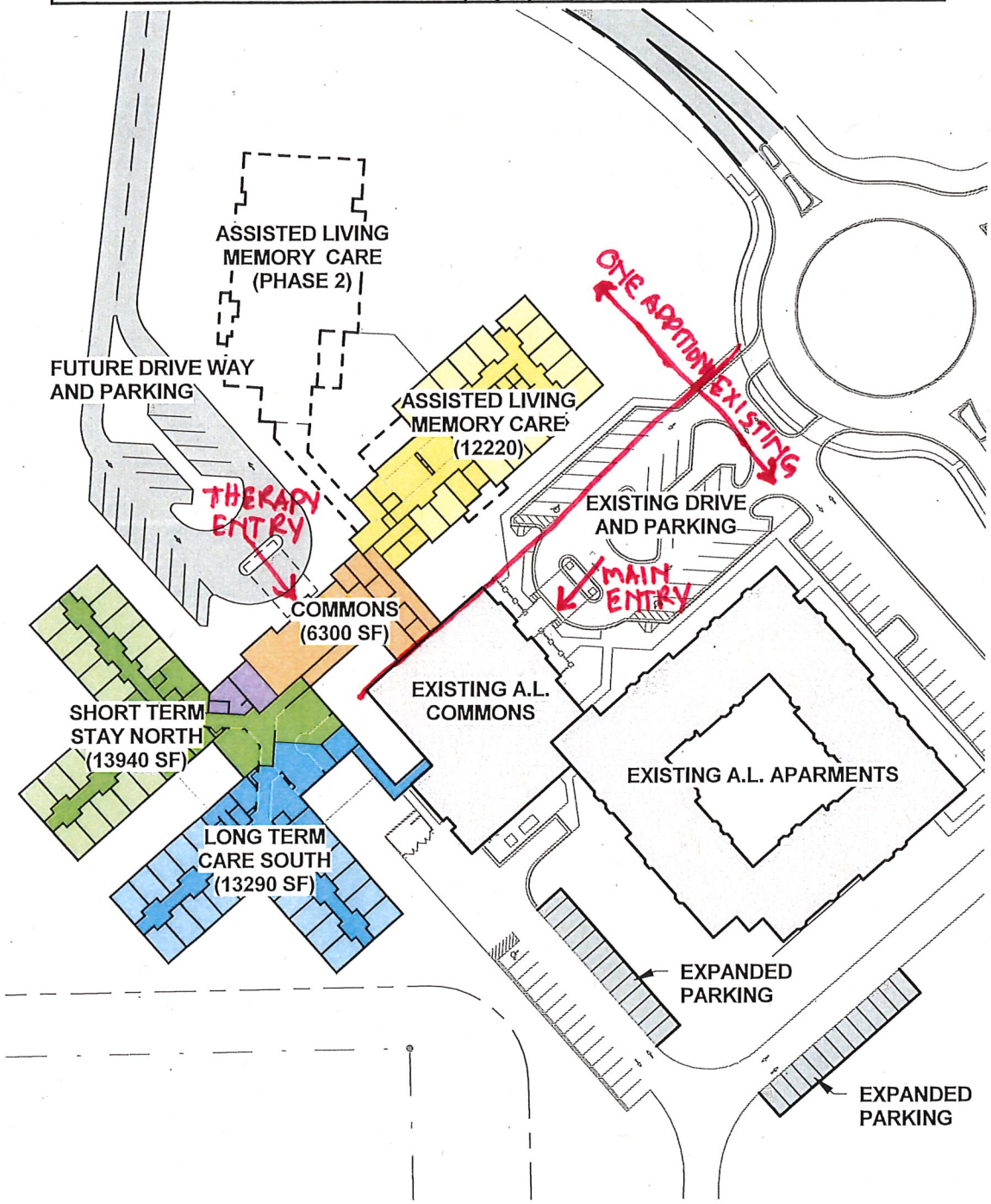
6. ADDENDUM 7 is a new cost/space chart in the format requested.

7. ADDENDUM 8 includes a referral letter from a primary referring hospital in the market area and a letter of support from the Chairman of the Board of the Mennonite Meadows Retirement Communities. Although physician letters are not included here, they will be sent electronically under separate cover. Pages 463-468 indicate the number of referrals to other facilities for skilled nursing admits from the local referring hospitals in response to Question #1 of Criterion 1125.540 Service Demand – Establishment of General Long Term Care. Unfortunately, we discovered that pages 466-468 were simply a duplication of pages 463-465, so please disregard.

8. By including a current list of all approved Certificate of Need applications that were deemed complete (pages 470-481), we were attempting to show verification that prospective resident referrals were not used to support another pending Certificate of Need (CON) application, as none of the applications included in ATTACHMENT 14C of the original application were in the market area for the proposed project.

| PROJECT AREAS | |
|---|---|
| SHORT TERM NORTH | 13940 |
| LONG TERM SOUTH | 13290 |
| (+SPA+RR+PT/OT) | 927 |
| COMMONS | 5373 |
| MEMORY CARE (AL) | 12220 |
| TOTAL (BGSF) | 45750 |

| SKILLED NURSING AREA | |
|---|---|
| SHORT TERM NORTH | 13940 |
| LONG TERM SOUTH | 13290 |
| (+SPA+RR+PT/OT) | 927 |
| TOTAL (BGSF) | 28157 |
| UTILIZATION (TOTAL/40 BEDS) | 704 SF/BED |




1 SITE PLAN
1" = 100'-0"

date
10/23/17
revised

drawn by
CML
checked by
SML

BLDD ARCHITECTS
Design Firm Registration #184-000723

SITE PLAN
MEADOWS AT MERCY CREEK
NORMAL, IL

sheet
AP101

project
174SI15.200

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## Facility/Project Identification

| | | | |
|---|---|---|---|
| Facility Name: The Village at Mercy Creek | | | |
| Street Address:1501 Mercy Creek Drive | | | |
| City and Zip Code: Normal, Il 61761 | | | |
| County: | McLean | Health Service Area: 4 | Health Planning Area: McLean |

## Applicant /Co-Applicant Identification

**[Provide for each co-applicant [refer to Part 1130.220].**

| **Co-Applicant** |
|---|
| Exact Legal Name: Franciscan Sisters of Chicago Service Corporation |
| Address: 11500 Theresa Dr, Lemont, Il 60439 |
| Name of Registered Agent: CT Corporation |
| Chief Executive Officer: Judy Amiano |
| CEO Address: 11500 Theresa Dr. Lemont, Il 60439 |
| Telephone Number: 866-286-8430 |

## Type of Ownership (Applicant/Co-Applicants)

| | | | | | |
|---|---|---|---|---|---|
| x | Non-profit Corporation | ☐ | Partnership | | |
| ☐ | For-profit Corporation | ☐ | Governmental | | |
| ☐ | Limited Liability Company | ☐ | Sole Proprietorship | ☐ | Other |

- Corporations and limited liability companies must provide an **Illinois certificate of good standing.**
- Partnerships must provide the name of the state in which organized and the name and address of each partner specifying whether each is a general or limited partner.

Appended as **ATTACHMENT 1** shows the Certificate of Good Standing. Franciscan Ministries, as sponsored by The Franciscan Sisters of Chicago, will be the Owner of the proposed site and building.

**APPEND DOCUMENTATION AS ATTACHoMENT-1 IN NUMERIC SEQUENTIAL ORDER AFTER THE LAST PAGE OF THE APPLICATION FORM.**

## Primary Contact

**[Person to receive ALL correspondence or inquiries)**

| |
|---|
| Name: Deborah Brown |
| Title: Health Care Consultant |
| Company Name: Franciscan Advisory Services, Inc. |
| Address: 11500 Theresa Lane |
| Telephone Number: 331-318-5191 |
| E-mail Address: dlbrown@franciscanministries.org |
| Fax Number: 331-318-5120 |

## Additional Contact

[Person who is also authorized to discuss the application for permit]

| |
|---|
| Name: John D Glover |
| Title: Chief Operating Officer |
| Company Franciscan Ministries |
| Address:11500 Theresa Dr. |
| Telephone Number: 331 318 5115 |
| E-mail Address: jglover@franciscanministries.org |
| Fax Number: 331 318 5120 |



ADDENDUM 2

THE VILLAGE AT MERCY CREEK
FRANCISCAN COMMUNITIES
*Franciscan Ministries sponsored by the Franciscan Sisters of Chicago*

Should the Illinois Health Facilities and Services Review Board approve the proposed project, and based upon the signature of the Chief Executive Officer of FRANCISCAN SISTERS OF CHICAGO SERVICE CORPORATION at page 6 of the Application for Permit #18-028 the debt financing for the establishment of a 40-bed skilled care facility at The Village of Mercy Creek will be guaranteed by the FRANCISCAN SISTERS OF CHICAGO SERVICE CORPORATION.

Judy Amiano

Judy Amiano, President & CEO

1501 Mercy Creek Drive, Normal, IL 61761
Phone 309.268.1501 • Fax 309.268.1498 • www.thevillageatmercycreek.org

# CONSOLIDATED FINANCIAL STATEMENTS

Franciscan Sisters of Chicago Service Corporation
and Subsidiaries
(d/b/a Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago)
Years Ended June 30, 2015 and 2014
With Report of Independent Auditors

ADDENDUM 3

**Franciscan Sisters of Chicago Service Corporation and Subsidiaries**

**Consolidated Financial Statements**

**Years Ended June 30, 2015 and 2014**

## Contents

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Consolidated Statements of Cash Flows ..... 7
Notes to Consolidated Financial Statements ..... 8

plante moran

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Independent Auditor's Report

To the Board of Directors
Franciscan Sisters of Chicago Service Corporation and Subsidiaries

We have audited the accompanying consolidated financial statements of Franciscan Sisters of Chicago Service Corporation and Subsidiaries (d/b/a Franciscan Ministries, sponsored by the Franciscan Sisters of Chicago) (Franciscan Ministries), which comprise the consolidated balance sheets as of June 30, 2015 and 2014 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 financial statements.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these 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.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these 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 audits 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 the auditor's 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, the auditor considers internal control relevant to the entity'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 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 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 Franciscan Sisters of Chicago Service Corporation and Subsidiaries (d/b/a Franciscan Ministries, sponsored by the Franciscan Sisters of Chicago) as of June 30, 2015 and 2014, and the results of their operations and changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

November 6, 2015

Praxity
MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Balance Sheets

| | June 30 | |
|---|---|---|
| | **2015** | **2014** |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ **20,136,208** | $ 20,982,008 |
| Assets limited as to use - externally designated under debt agreements | **939,675** | 776,661 |
| Accounts receivable, less allowances for uncollectible accounts of $2,528,630 and $2,191,994 in 2015 and 2014, respectively | **6,740,878** | 7,879,148 |
| Due from affiliates | **86,124** | 83,495 |
| Due from third-party payors | **227,777** | 254,556 |
| Prepaid expenses and other | **4,093,451** | 4,770,129 |
| Total current assets | **32,224,113** | 34,745,997 |
| Assets limited as to use, net of amounts required to meet current obligations: | | |
| Internally designated for capital improvements | **86,798,687** | 78,629,852 |
| Externally designated under debt agreements and letters of credit | **22,711,508** | 25,327,018 |
| | **109,510,195** | 103,956,870 |
| Deferred bond issuance costs | **4,712,008** | 4,871,696 |
| Long-term investments | **1,003,826** | 1,022,973 |
| Other long-term assets | **2,090,883** | 2,367,807 |
| Property and equipment, net | **162,664,520** | 160,142,991 |
| Total assets | $ **312,205,545** | $ 307,108,334 |

*See accompanying notes to consolidated financial statements.*



ADDENDUM 3

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Balance Sheets (Continued)

| | June 30 | |
|---|---|---|
| | 2015 | 2014 |
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ **16,216,221** | $ 16,117,457 |
| Accrued salaries and employee benefits | **6,943,889** | 6,888,050 |
| Due to affiliates | **485,857** | - |
| Due to third-party payors | **977,699** | 965,582 |
| Current maturities of long-term debt | **2,061,242** | 2,031,394 |
| Current maturities of note payable to affiliate | **217,384** | 207,477 |
| Refundable resident deposits and entrance fees | **5,658,681** | 5,891,566 |
| Total current liabilities | **32,560,973** | 32,101,526 |
| Noncurrent liabilities: | | |
| Long-term debt, less current maturities | **177,910,146** | 181,568,535 |
| Note payable to affiliate, less current maturities | **4,987,707** | 5,205,149 |
| Section 1602 deferred grant revenue | **3,609,211** | 3,766,133 |
| Refundable resident deposits and refundable and nonrefundable entrance fees | **71,310,609** | 69,895,860 |
| Asset retirement obligations and other | **1,674,807** | 1,681,620 |
| | **259,492,480** | 262,117,297 |
| Total liabilities | **292,053,453** | 294,218,823 |
| Net assets: | | |
| Noncontrolling interests in subsidiaries | **3,106,139** | 3,761,331 |
| Net assets: | | |
| Unrestricted | **8,709,744** | 6,819,255 |
| Temporarily restricted | **7,606,000** | 1,578,716 |
| Permanently restricted | **730,209** | 730,209 |
| | **17,045,953** | 9,128,180 |
| Total net assets | **20,152,092** | 12,889,511 |
| Total liabilities and net assets | $ **312,205,545** | $ 307,108,334 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Statements of Operations and Changes in Net Assets

| | Years Ended June 30 | |
|---|---|---|
| | **2015** | **2014** |
| **Unrestricted revenues, gains, and other support** | | |
| Net resident service revenue, including amortization of entrance fees of $1,646,312 in 2015 and $1,618,083 in 2014 | **$ 114,748,715** | $ 119,462,637 |
| Contracted labor revenue | **9,503,703** | 3,132,214 |
| Lease revenue | **1,702,974** | 1,240,824 |
| Management services fee revenue | **974,537** | 839,010 |
| Other operating revenue | **4,578,671** | 4,154,726 |
| Total unrestricted revenues, gains, and other support | **131,508,600** | 128,829,411 |
| **Expenses** | | |
| Salaries and wages | **55,798,310** | 53,988,365 |
| Employee benefits | **10,976,116** | 10,521,836 |
| Agency | **142,599** | 261,835 |
| Purchased services - resident | **6,849,296** | 8,151,897 |
| Purchased services - general | **10,610,412** | 11,304,651 |
| Drugs, food, supplies, and other | **10,846,580** | 11,497,020 |
| Administrative, utilities, and insurance | **14,262,663** | 14,312,704 |
| Provision for uncollectible accounts | **1,184,884** | 944,696 |
| Interest | **8,906,527** | 8,973,716 |
| Depreciation and amortization | **12,199,281** | 12,023,681 |
| Total operating expenses | **131,776,668** | 131,980,401 |
| Loss from continuing operations | **(268,068)** | (3,150,990) |
| **Nonoperating** | | |
| Realized investment income | **3,844,426** | 5,632,810 |
| Net change in unrealized gains/losses on investments - trading portfolio | **(1,031,661)** | 1,105,641 |
| Loss on refinancing of long-term debt | **(65,073)** | – |
| Litigation settlements | **(724,066)** | – |
| Contribution revenue and other | **123,918** | 526,259 |
| Total nonoperating | **2,147,544** | 7,264,710 |
| Revenues in excess of expenses from continuing operations | **1,879,476** | 4,113,720 |
| Discontinued operations: | | |
| Revenues in excess of expenses from discontinued operations | – | 237,214 |
| Revenues in excess of expenses | **1,879,476** | 4,350,934 |
| Revenues in excess of expenses allocated to noncontrolling interests | **655,192** | 437,889 |
| Revenues in excess of expenses allocated to Franciscan Sisters of Chicago Service Corporation | **2,534,668** | 4,788,823 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

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

| | Years Ended June 30 | |
|---|---|---|
| | 2015 | 2014 |
| **Other changes in unrestricted net assets** | | |
| Net change in unrealized losses on investments – other-than-trading portfolio | $ (205,129) | $ (253,973) |
| Net assets released from restrictions used for capital purposes | 60,950 | 65,492 |
| Transfers to affiliates | (500,000) | – |
| Total other changes in unrestricted net assets | (644,179) | (188,481) |
| Increase in unrestricted net assets | 1,890,489 | 4,600,342 |
| **Temporarily restricted net assets** | | |
| Contributions for specific programs and asset purchases | 1,049,470 | 865,200 |
| Contributions of land lease rights - Net | 5,481,540 | – |
| Net assets released from restrictions | (503,726) | (354,272) |
| Increase in temporarily restricted net assets | 6,027,284 | 510,928 |
| **Permanently restricted net assets** | | |
| Investment income | 6,671 | 38,104 |
| Transfers to unrestricted net assets | (6,671) | (38,104) |
| Change in permanently restricted net assets | – | – |
| Increase in net assets | 7,917,773 | 5,111,270 |
| **Changes in net assets of noncontrolling interest** | | |
| Net loss of noncontrolling interests in subsidiaries | (655,192) | (437,889) |
| Decrease in net assets of noncontrolling interests | (655,192) | (437,889) |
| Net increase in total net assets | 7,262,581 | 4,673,381 |
| Net assets at beginning of year | 12,889,511 | 8,216,130 |
| Net assets at end of year | $ 20,152,092 | $ 12,889,511 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Statements of Cash Flows

| | Years Ended June 30 | |
|---|---|---|
| | 2015 | 2014 |
| **Operating activities** | | |
| Increase in net assets | $ 7,262,581 | $ 4,673,381 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 12,199,281 | 12,023,681 |
| Amortization of entrance fees | (1,646,312) | (1,618,083) |
| Amortization of Section 1602 grants | (156,922) | (156,922) |
| Loss on refinancing of long-term debt | 65,075 | – |
| Loss on disposal of assets | 18,665 | 79,144 |
| Provision for uncollectible accounts | 1,184,884 | 944,696 |
| Restricted contributions, net of assets released from restrictions used for operations | (545,744) | (510,928) |
| Contribution of land lease rights - Net | (5,481,540) | – |
| Net change in unrealized losses and (gains) on investments | 1,236,790 | (851,668) |
| Transfer to affiliate | 500,000 | – |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and due to/from third-party payors | (7,718) | 274,286 |
| Accounts payable, accrued salaries, prepaid expenses, deferred marketing costs, and other | 1,045,124 | (2,793,815) |
| Nonrefundable entrance fees | 1,904,869 | 1,327,738 |
| Due to (from) affiliate | 483,228 | (73,645) |
| Net cash provided by operating activities | 18,062,261 | 13,317,865 |
| **Investing activities** | | |
| Purchases of property and equipment, net, and other | (8,838,002) | (11,068,240) |
| Proceeds from sale of assets | 736 | 200 |
| Purchase of assets limited as to use and other investments - trading portfolio, net | (7,381,846) | (5,737,208) |
| Sales of assets limited as to use and other investments - other-than-trading portfolio, net | 447,864 | 1,392,803 |
| Net cash used in investing activities | (15,771,248) | (15,412,445) |
| **Financing activities** | | |
| Retirement of long-term debt | (1,466,280) | – |
| Payments of long-term debt | (2,162,261) | (2,157,451) |
| Payments on note payable to affiliate | (207,535) | (193,096) |
| Payment of bond issuance costs | (86,003) | (22,428) |
| Transfers to affiliates | (500,000) | – |
| Proceeds from refundable resident deposits | 10,731,733 | 9,421,026 |
| Refunds of resident deposits | (9,992,211) | (7,435,003) |
| Proceeds from restricted contributions and gains on investments, net of assets released from restrictions | 545,744 | 510,928 |
| Net cash (used in) provided by financing activities | (3,136,813) | 123,976 |
| Decrease in cash and cash equivalents | (845,800) | (1,970,604) |
| Cash and cash equivalents at beginning of year | 20,982,008 | 22,952,612 |
| Cash and cash equivalents at end of year | $ 20,136,208 | $ 20,982,008 |

*See accompanying notes to consolidated financial statements.*

# Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Notes to Consolidated Financial Statements

## June 30, 2015 and 2014

### 1. Organization and Summary of Significant Accounting Policies

### Organization and Basis of Presentation

Franciscan Sisters of Chicago Service Corporation and Subsidiaries, which is sponsored by the Franciscan Sisters of Chicago (the Sisters), is an Illinois not-for-profit corporation, which coordinates all of the Sisters' sponsored facilities and assists the Sisters in extending their charitable mission in health care and educational foundations in the Chicago metropolitan area, northern Indiana, Ohio, and Kentucky. Effective February 2015, Franciscan Sisters of Chicago Service Corporation began doing business as Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago (Franciscan Ministries).

The consolidated financial statements include the accounts and transactions of Franciscan Ministries (Service Corporation), Franciscan Communities, Inc. Obligated Group (Obligated Group), SAMC, Inc. (Medical Center), St. Joseph Senior Housing (St. Joseph Housing), Franciscan Community Services, Inc. (Community Services), Franciscan Community Benefit Services, Inc. (CBS), and Franciscan Advisory Services, Inc. (FAS). The operating divisions of CBS include Madonna Foundation and St. Jude House, Inc. The operating divisions of St. Joseph Housing include Crete Senior Housing I, LLC, Crete Senior Housing Phase II, LLC, and Louisville Senior Housing, LLC. The portion of Crete Senior Housing Phase II, LLC and Louisville Senior Housing, LLC not owned by St. Joseph Housing is reported as noncontrolling interest in the consolidated financial statements.

The members of the Obligated Group include Franciscan Communities, Inc. (Franciscan Communities) and University Place, Inc. Franciscan Communities includes the following operating divisions: Addolorata Villa, Franciscan Village, Marian Village, Mount Alverna Village (Mount Alverna), St. Anthony Home (St. Anthony), St. Anthony Management Services (Management Services), St. Joseph Village of Chicago (St. Joseph), and The Village at Victory Lakes (Victory Lakes). Franciscan Communities also includes the operations of the following operating divisions, discontinued effective February 28, 2009: Franciscan Healthcare Center (Franciscan), George Davis Manor (George Davis), St. Clare Healthcare Center (St. Clare), St. Elizabeth Healthcare Center (St. Elizabeth), St. James Manor and Villas (St. James), and St. Mary Healthcare Center (St. Mary).

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

Franciscan Ministries, the Obligated Group, Community Services, Medical Center, and CBS are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the "Code") and are not private foundations within the meaning of Section 509(a) of the Code. St. Joseph Housing is a tax-exempt organization under Section 501(c)(4) of the Code and is not a private foundation within the meaning of Section 509(a) of the Code.

A for-profit subsidiary of the Franciscan Ministries, FAS was incorporated on June 16, 2011 with the purpose of managing certain ministries of the Sisters that did not meet the definition of the exempt purpose of Franciscan Ministries.

All significant intercompany transactions have been eliminated in consolidation.

### 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 at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time that the estimates are made, actual results could differ.

### Cash Equivalents

It is Franciscan Ministries' policy to reflect all investments that are not limited as to use and that have a maturity of three months or less at the time of acquisition as cash equivalents.

### Cash Concentration

Franciscan Ministries has cash on deposit with financial institutions which at times may be in excess of federally insured limits.

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

### Assets Limited as to Use and Other Investments

Assets limited as to use consist of investments set aside by the Board of Directors for future capital improvements, over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes. In addition, assets limited as to use include, investments held by trustees under debt agreements and amounts as collateral for workers' compensation letters of credit.

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. Investment income is included in revenues in excess of expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses in the value of other-than-trading portfolio investments are recognized as changes in unrestricted net assets, while the unrealized gains and losses in the value of the trading portfolio investments are recognized as a non-operating gain or loss.

Effective November 1, 2002, Franciscan Ministries established an investment pool. Investments of Franciscan Ministries held in the investment pool amounted to $82,734,701 and $73,912,872 at June 30, 2015 and 2014, respectively, and are included in assets limited as to use, internally designated for capital improvements.

Franciscan Ministries' investments are exposed to various risks, such as interest rate, market and, credit risk. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in risks in the near term could materially affect the amounts reported in the consolidated balance sheets.

### Accounts Receivable

Accounts receivable for residents, insurance companies, and governmental agencies are based on net charges. Franciscan Ministries evaluates the collectibility of its accounts receivable based on the length of time the receivable is outstanding, payor class, and the anticipated future uncollectible amounts based on historical experience. Accounts receivable are charged to the allowance for uncollectible accounts when they are deemed uncollectible. Franciscan Ministries does not require collateral.

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

### Deferred Bond Issuance Costs

Expenses incurred in connection with the issuance of bonds are deferred and amortized over the life of the bonds. Deferred bond issuance costs are stated net of accumulated amortization of $907,598 and $726,982 at June 30, 2015 and 2014, respectively.

### Property and Equipment

Property and equipment are stated on the basis of cost or, if donated to Franciscan Ministries, at fair value on the date of acquisition. Provisions for depreciation are computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 40 years.

Costs directly related to the acquisition, development, and improvement of real estate are capitalized, including interest and other costs incurred during the construction period. Costs incurred for significant repairs and maintenance that extend the usable life of the asset or have a determinable useful life are capitalized. Ordinary repairs and maintenance are expensed as incurred.

### Land Lease Rights

Franciscan Ministries has rights to lease from related party 30.8 acres of land at Franciscan Village and 80.0 acres of land at Marian Village through June 30, 2050. Each of these leases call for annual payments of $1 throughout the term of the lease agreements. Franciscan Ministries has determined that the required lease payments are less than fair value and therefore has recorded the estimated fair value of future lease payments as land lease rights in property and equipment on the combined balance sheet and a contribution of land lease rights as a change in temporarily restricted net assets both totaling $5,481,540. Both balances are amortized as lease expense and an unrestricted contribution over the terms of the leases.

### Asset Retirement Obligations

Asset retirement obligations represent an obligation to dispose of assets that are legally required to be removed at a future date. Such obligations are recorded at the net present value using a risk-free interest rate and inflationary rate. As of June 30, 2015 and 2014, the asset retirement obligation for Franciscan Ministries was $492,315 and $477,976, respectively, and is included in asset retirement obligations and other in the consolidated balance sheets.

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

### Refundable Resident Deposits and Entrance Fees

Franciscan Ministries offers various independent living residency agreement options including rental agreements and entrance fees with variable contract options, which include 90% refundable, 50% refundable, and fully amortizable programs.

Refundable resident deposits represent amounts received from prospective independent living residents, placing them on a priority list and making them eligible, once qualified, to receive certain resident benefits upon occupancy. A deposit of 10% of the entrance fee for the unit selected under the residency agreement makes the residents eligible to receive certain other benefits.

Upon a residents' occupancy, an entrance fee is reported as refundable to the extent the entrance fee is refundable to the resident according to the residency agreement. Nonrefundable entrance fees are reported as nonrefundable entrance fees. Nonrefundable entrance fees are amortized into revenue using the straight-line method based on the estimated life of the resident or contract term, if shorter. Franciscan Ministries may require entrance fees from assisted living residents. The entrance fees are refundable, in varying amounts, to the residents upon termination of the residency agreements. Total entrance fee amortization reported as net resident service revenue amounted to $1,646,312 and $1,618,083 for the years ended June 30, 2015 and 2014, respectively.

Franciscan Ministries offers various entrance fee plans to prospective residents. Based upon the type of plan, Franciscan Ministries may have a financial obligation to provide future healthcare benefits to the residents. Management calculated the future service obligation at June 30, 2015 and 2014, and concluded that there is no liability as of June 30, 2015 and 2014.

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

### Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets include assets whose use has been limited by donors to a specific time period or purpose and contributed land lease rights. Permanently restricted net assets have been restricted by donors to be maintained by Franciscan Ministries and its related companies in perpetuity. Assets released from restrictions that are used for capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to unrestricted net assets. Assets released from restrictions that are used for operating purposes are reported in the consolidated statements of operations and changes in net assets as other operating revenue. Earnings on restricted net assets are recorded as temporarily restricted net assets until amounts are expended in accordance with donors' specifications.

### Contributions

Contributions are reported at fair value at the date of the contribution. Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost.

### Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. The gifts are reported as either temporarily or permanently restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets.

### Community Commitment

Franciscan Ministries provides care to residents who meet certain criteria without charge or at amounts less than established rates. Services to residents are classified as charity care in accordance with established criteria. Charity care represents services rendered for which partial payment is less than cost or no payment is expected and, as such, is not included in the net resident service revenue in the consolidated statements of operations and changes in net assets.

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

### Net Resident Service Revenue

Franciscan Ministries has agreements with third-party payors that provide for payments to Franciscan Ministries at amounts different from its established rates. Payment arrangements include prospectively determined rates, discounted charges, and per diem payments. Net resident service revenue is reported at the estimated net realizable amounts from residents, third-party payors, and others for services rendered.

### Impairment of Long-Lived Assets

Franciscan Ministries considers whether indicators of impairment are present and performs the necessary tests in accordance with generally accepted accounting principles to determine if the carrying value of the asset is impaired. Impairment is recognized when estimated undiscounted operating income before depreciation and amortization is less than the carrying value of the property. To the extent that impairment has occurred, the excess of carrying value of the property over its estimated fair value is charged to operations. Impairment write-downs, if any, are reflected in loss from continuing operations. There was no impairment for the years ended June 30, 2015 and 2014.

### Revenues in Excess of Expenses

The consolidated statements of operations and changes in net assets include revenues in excess of expenses. Changes in unrestricted net assets, which are excluded from revenues in excess of expenses, include changes in the unrealized gains and losses on other-than-trading portfolio investments, transfers to affiliates, and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction, were to be used for the purpose of acquiring such assets).

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

### Federal Income Tax

Franciscan Ministries has analyzed the tax positions taken in its filings with the Internal Revenue Service ("IRS") and state jurisdictions where it operates. Franciscan Ministries believes that its income tax filing positions will be sustained upon examination and does not anticipate any adjustments that would result in a material adverse effect on Franciscan Ministries' financial condition, results of operations, or cash flows. Accordingly, Franciscan Ministries has not recorded any reserves or related accruals for interest and penalties for uncertain income tax positions at June 30, 2015 and 2014.

### Accounting Standards Update

During May 2014, the Financial Accounting Standards Board released Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The amendments in the ASU clarify the principles for recognizing revenue and develop a common revenue standard for generally accepted accounting principles that removes inconsistencies and weaknesses in revenue requirements, provides a more robust framework for addressing revenue issues, improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets, provides more useful information to users of financial statements through improved disclosure requirements, and simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. Franciscan Ministries will be required to adopt and implement this accounting update as of and for the year ending June 30, 2019. Management has not yet assessed the effect of this accounting standards update on the consolidated financial statements.

## 2. Contractual Arrangements with Third-Party Payors

Franciscan Ministries provides care to certain residents under payment arrangements with Medicare, Medicaid, and various health maintenance and preferred provider organizations. Services provided under these arrangements are paid at predetermined rates and/or per diem rates, as defined. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, and as a result, there is a possibility that recorded estimates may change.

## 2. Contractual Arrangements with Third-Party Payors (continued)

Amounts received under Medicare and Medicaid payment arrangements accounted for 34% and 37% of Franciscan Ministries' net resident service revenue in 2015 and 2014, respectively. Medicare and Medicaid accounts receivable accounted for 62% of Franciscan Ministries' net accounts receivable at June 30, 2015 and 2014.

Provision has been made in the consolidated financial statements for estimated contractual adjustments, recorded in net resident revenue in the consolidated statements of operations and changes in net assets, representing the difference between Franciscan Ministries' standard charges for services and the estimated ultimate payment from various third-party payors.

## 3. Entrance Fees and Deposits

Franciscan Ministries may require security deposits of various amounts from private pay residents at the time of admission for nursing care. The security deposits are fully refundable to the residents upon discharge from a community. The security deposits are included in current liabilities and reported as refundable resident deposits and entrance fees. The security deposits amounted to $638,382 and $599,930 at June 30, 2015 and 2014, respectively.

Franciscan Ministries requires entrance fees from assisted living residents. The refundable portion of the entrance fees varies by community and is refundable to the resident upon discharge from the community. The refundable portion of the entrance fees is included in current liabilities and reported as refundable resident deposits and entrance fees. The nonrefundable portion of the entrance fee is included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $911,162 and $860,369 at June 30, 2015 and 2014, respectively. The nonrefundable portion of these entrance fees amounted to $281,702 and $168,846 at June 30, 2015 and 2014, respectively.

Franciscan Ministries also requires entrance fees, in varying amounts, under other independent living residency agreements. Under the terms of these residency agreements, the amount of the refundable portion varies and is refundable upon termination, reoccupancy of the vacated unit, and leaving the community before amounts are required to be refunded. The refundable and nonrefundable portions of the entrance fees are included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $64,982,232 and $63,758,231 at June 30, 2015 and 2014, respectively. The nonrefundable portion of these entrance fees amounted to $5,709,113 and $5,686,064 at June 30, 2015 and 2014, respectively.

### 3. Entrance Fees and Deposits (continued)

Prospective independent living residents are subject to reservation deposits up to a maximum of 10% of the entrance fee for the unit selected under the residency agreements, making the residents eligible to receive certain other benefits. Upon occupancy, the resident is charged the remaining 90% of the entrance fee. The reservation deposits are fully refundable if the contract is terminated prior to occupancy, and they are included in current liabilities and reported as refundable resident deposits and entrance fees. Reservation deposits amounted to $222,751 and $199,523 at June 30, 2015 and 2014, respectively.

Franciscan Ministries requires entrance fees, in varying amounts, in certain independent living residency agreements. Under the terms of these residency agreements, the amount of the refundable portions varies and is refundable upon termination of the residency agreements. The refundable portion of the entrance fee is included in current liabilities and reported as refundable resident deposits and entrance fees. The nonrefundable portion is included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $3,886,385 and $4,128,221 at June 30, 2015 and 2014, respectively. The nonrefundable portion of these entrance fees amounted to $337,563 and $282,719 at June 30, 2015 and 2014, respectively.

### 4. Investments and Other Financial Instruments

Total investment return for the years ended June 30 is summarized as follows:

| | 2015 | 2014 |
|---|---|---|
| Dividend and interest income | **$ 1,809,264** | $ 1,823,842 |
| Realized gains | **2,492,928** | 4,144,449 |
| Investment fees | **(350,451)** | (271,225) |
| Unrealized gains/losses | **(1,236,790)** | 851,668 |
| | **$ 2,714,951** | $ 6,548,734 |

**4. Investments and Other Financial Instruments (continued)**

As reported:

| | 2015 | 2014 |
|---|---|---|
| Other operating revenue | **$ 107,315** | $ 64,256 |
| Nonoperating: | | |
| Net investment income | **3,844,426** | 5,632,810 |
| Net change in unrealized gains/losses on investments - trading portfolio | **(1,031,661)** | 1,105,641 |
| Other changes in unrestricted net assets - | | |
| Net change in unrealized gains/losses on investments - other-than-trading portfolio | **(205,129)** | (253,973) |
| | **$ 2,714,951** | $ 6,548,734 |

**5. Fair Value Measurements**

Accounting Standards Codification (ASC) 820, *Fair Value Measurement and Disclosures,* establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of input that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date. The fair values of debt and equity investments that are readily marketable are determined by obtaining quoted prices on nationally recognized securities exchanges.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

## 5. Fair Value Measurements (continued)

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy.

### Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below as of June 30, 2015:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Internally designated investments: | | | | |
| Franciscan Ministries Investment Pool: | | | | |
| Equities – domestic | $ 31,453,316 | $ 7,576,432 | $ - | $ 39,029,748 |
| Equities – international | 1,020,393 | - | - | 1,020,393 |
| Equities – mutual funds | 5,068,357 | - | - | 5,068,357 |
| Mutual fund - fixed income | 30,492,062 | 3,896 | - | 30,495,958 |
| Cash and cash equivalents | 7,120,245 | - | - | 7,120,245 |
| Total Franciscan Ministries Investment Pool | 75,154,373 | 7,580,328 | - | 82,734,701 |
| Fixed income | 4,063,986 | - | - | 4,063,986 |
| Total internally designated investments | 79,218,359 | 7,580,328 | - | 86,798,687 |
| Externally designated investments: | | | | |
| Fixed income | - | 11,736,537 | - | 11,736,537 |
| Cash and cash equivalents | 11,914,646 | - | - | 11,914,646 |
| Total externally designated investments | 11,914,646 | 11,736,537 | - | 23,651,183 |
| Long-term investments: | | | | |
| Pooled equity funds | 1,003,826 | - | - | 1,003,826 |
| | $ 92,136,831 | $ 19,316,865 | $ - | $ 111,453,696 |

## 5. Fair Value Measurements (continued)

Assets measured at fair value on a recurring basis are summarized below as of June 30, 2014:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Internally designated investments: | | | | |
| Franciscan Ministries Investment Pool: | | | | |
| Equities – domestic | $ 25,207,932 | $ 6,244,399 | $ - | $ 31,452,331 |
| Equities – international | 1,153,679 | - | - | 1,153,679 |
| Equities – mutual funds | 5,168,439 | - | - | 5,168,439 |
| Mutual fund - fixed income | 25,528,639 | 4,692 | - | 25,533,331 |
| Cash and cash equivalents | 10,605,093 | - | - | 10,605,093 |
| Total Franciscan Ministries Investment Pool | 67,663,782 | 6,249,091 | - | 73,912,873 |
| Fixed income | 4,716,979 | - | - | 4,716,979 |
| Total internally designated investments | 72,380,761 | 6,249,091 | - | 78,629,852 |
| Externally designated investments: | | | | |
| Fixed income | - | 3,415,910 | - | 3,415,910 |
| Cash and cash equivalents | 22,687,769 | - | - | 22,687,769 |
| Total externally designated investments | 22,687,769 | 3,415,910 | - | 26,103,679 |
| Long-term investments: | | | | |
| Pooled equity funds | 1,022,973 | - | - | 1,022,973 |
| | $ 96,091,503 | $ 9,665,001 | $ - | $ 105,756,504 |

Fair value for Level 1 assets is based on quoted market prices. Level 2 investments are valued by pricing services utilized by Franciscan Ministries' investment managers in which quoted market prices for similar instruments in active markets are used to determine fair value.

As of June 30, 2015 and 2014, there are no liabilities measured at fair value on a recurring basis.

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses are reasonable estimates of their fair values due to the short-term nature of those financial instruments. The carrying values of certain retirement liabilities related to deferred compensation plans are reasonable estimates of their fair value as they equate the fair value of the assets held within the deferred compensation plan.

## 5. Fair Value Measurements (continued)

It is not practicable to estimate the fair values of amounts due to/from affiliates, as timing of future cash flows is uncertain and/or the debtors' ability to borrow with similar terms from an unrelated party cannot be determined.

Franciscan Ministries' policy is to recognize transfers in and transfers out of Levels 1, 2, and 3 fair value classifications as of the actual date of the event of change in circumstances that caused the transfer. There were no transfers between levels at June 30, 2015 and 2014.

Franciscan Ministries invests in an equity fund held within the investment pool that does not have a readily determinable market value. Therefore, the fair value is based on net asset value per share and is classified as Level 2. The investment has a fair value of $7,576,432 and $6,244,399 at June 30, 2015 and 2014, respectively. The investment shares are not transferable and may only be redeemed through the fund. Redemption can occur based on the fair value of net assets held on no more than a monthly basis and requires a 30-day notice. The fund's primary strategy is to invest in a diversified portfolio of non-U.S. stocks.

## 6. Property and Equipment

Property and equipment are as follows at June 30:

| | 2015 | 2014 |
|---|---|---|
| Land and improvements | **$ 41,473,172** | $ 40,121,598 |
| Land lease rights | **5,481,540** | - |
| Buildings and improvements | **246,994,107** | 243,501,537 |
| Furniture and movable equipment | **34,195,856** | 32,328,255 |
| Construction-in-progress | **2,411,846** | 721,044 |
| | **330,556,521** | 316,672,434 |
| Less accumulated depreciation | **167,892,001** | 156,529,443 |
| | **$ 162,664,520** | $ 160,142,991 |
| Depreciation expense | **$ 11,778,943** | $ 11,596,820 |

## 7. Long-Term Debt

Long-term debt consisted of the following at June 30:

| | 2015 | 2014 |
|---|---|---|
| Illinois Finance Authority Revenue Bonds: | | |
| Series 2004B, principal payable in varying annual installments from 2026 through 2034; interest rate 6.50%, rate change date May 15, 2034 | **$ 3,060,000** | $ 3,060,000 |
| Series 2007A, principal payable in varying annual installments from 2013 through 2037; interest rates ranging from 5.25% to 5.50% | **40,140,000** | 40,160,000 |
| Series 2013A, principal payable in varying annual installments from 2014 through 2047; interest rate ranging from 2.15% to 5.25% | **97,330,000** | 98,830,000 |
| Series 2013B, principal payable in varying monthly installments from 2013 through 2043; interest rates vary monthly based on prevailing market conditions (2.10% and 2.08% at June 30, 2015 and 2014, respectively) | **10,700,101** | 10,930,695 |
| The Huntington National Bank: | | |
| Series 2013C, principal payable in varying monthly installments from 2013 through 2043; interest rates vary monthly based on prevailing market conditions (2.74% and 2.70% at June 30, 2015 and 2014, respectively) | **15,634,773** | 15,998,745 |
| County of Cuyahoga, Ohio Healthcare Facilities Revenue Bonds: | | |
| Series 2004C, principal payable in varying annual installments from 2028 through 2032; interest rate 6.25% | **5,255,000** | 5,255,000 |
| Series 2004D, principal payable in varying annual installments from 2033 through 2034; interest rate 6.50%, rate change date May 15, 2034 | **2,745,000** | 2,745,000 |
| US Bank National Association Mortgage Note, interest at 6.97% | **-** | 1,466,279 |
| Illinois Housing Development Authority Mortgage Note, interest at 3.75%, principal due 2049; interest paid monthly | **2,363,208** | 2,394,702 |

**7. Long-Term Debt (continued)**

| | 2015 | 2014 |
|---|---|---|
| Illinois Housing Development Authority Mortgage Note, interest-only payments through 2017, principal due 2047; interest paid monthly; interest rate 1.0% | **$ 1,111,000** | $ 1,111,000 |
| Illinois Housing Development Authority Mortgage Note, principal due 2047; interest rate 6.08% | **1,632,306** | 1,648,508 |
| | **179,971,388** | 183,599,929 |
| Less current maturities of long-term debt | **2,061,242** | 2,031,394 |
| | **$177,910,146** | $181,568,535 |

Annual maturities of long-term debt and sinking fund requirements as of June 30, 2015, for each of the next five years, are as follows:

| | |
|---|---|
| 2016 | $ 2,061,242 |
| 2017 | 3,004,337 |
| 2018 | 3,074,171 |
| 2019 | 3,200,147 |
| 2020 | 3,355,249 |
| Thereafter | 165,276,242 |

The Obligated Group was formed on August 1, 1994. The original participants included St. Anthony, St. Joseph, and Mount Alverna. Franciscan Village became a participant in the Obligated Group effective August 15, 1996. Addolorata Villa became a participant in the Obligated Group effective November 14, 1996. Effective November 1, 1998, St. Clare, St. Elizabeth, St. Mary, and George Davis became participants in the Obligated Group. Effective January 1, 2001, Franciscan became a participant in the Obligated Group. Effective July 1, 2001, Marian Village and St. James became participants Obligated Group. Effective July 12, 2006, Victory Lakes became a participant in the Obligated Group. Effective March 13, 2013, University Place, Inc. became a participant in the Obligated Group.

**7. Long-Term Debt (continued)**

The maturity of the Series 2013B Bonds will be May 15, 2043, and the stated due date of the Taxable Term Loan is January 5, 2023. Despite the nominal maturity date of the Series 2013B Bonds, the commitment of the holder of the Series 2013 B bonds expires on January 5, 2023, at which time the Series 2013B Bonds may be subject to mandatory purchase by the Obligated Group. In addition, if the Obligated Group defaults under the Taxable Term Loan, The Huntington National Bank (the "Bank") may elect to accelerate the maturity of the Taxable Term Loan. If such events occur, the Obligated Group would be required to refinance such indebtedness at that time.

Under the terms of the long-term debt arrangements, various amounts are on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The terms of certain long-term debt agreements also grant a security interest in the Obligated Group's gross revenues. In addition, the indenture restricts the Obligated Group from encumbering substantially all of its property, limits additional indebtedness, and requires maintenance of various financial ratios. The Obligated Group has Mortgage and Security Agreements and Leasehold Mortgage and Security Agreements, dated March 13, 2013, with the Master Trustee and the Bank as security for the Series 2013 Bonds and Taxable Term Loan, providing substantially all property, plant, and equipment, and certain other assets as collateral, subject to the terms of certain ground leases.

Crete Senior Housing, LLC has a secured first mortgage in the property with the Illinois Housing Development Authority in the amount of $1,648,507 and a second secured mortgage note in the amount of $1,111,000. Crete Senior Housing Phase II, LLC has a secured mortgage in the property with the Illinois Housing Development Authority in the amount of $2,394,702. Louisville Senior Housing, LLC had a secured mortgage in the property with US Bank, National Association in the amount of $1,466,280. Effective October 2, 2014, Louisville Senior Housing, LLC entered into a secured mortgage note with Franciscan Ministries in the amount of $1,799,733. The loan is amortized over 35 years with an interest rate of 4.00% with a balloon payment due May 2030. Monthly principal and interest on the loan total $7,969. Franciscan Ministries has a secured first mortgage in the property. The proceeds of the loan were used to retire the US Bank, National Association mortgage note and cost of issuance.

Interest paid on long-term debt amounted to $8,962,989 and $9,047,792 in 2015 and 2014, respectively.

Interest was capitalized in the amount of $60,363 and $81,723 during the years ended June 30, 2015 and 2014, respectively.

### 7. Long-Term Debt (continued)

The estimated fair value of long-term debt based on quoted market prices for the same or similar issues was $2,670,940 more and $480,989 less than its carrying value at June 30, 2015 and 2014, respectively. Based on the inputs in determining the estimated fair values of the debt, this liability would be considered a Level 2 within the fair value hierarchy.

The provisions of the Master Trust Indenture and the Taxable Term Loan as described above contain various restrictive covenants that limit the occurrence of additional debt and require certain measures of financial performance be satisfied as long as the bonds and Taxable Bank Loan are outstanding. Failure to maintain compliance could result in acceleration of payment for debt outstanding under the Master Trust Indenture and Taxable Bank Loan. Management believes Franciscan Ministries is in compliance with such covenants at both June 30, 2015 and 2014.

### 8. Grant Agreements

Crete Senior Housing Phase II, LLC (Crete II) has entered into a Section 1602 written agreement with the Illinois Housing Development Authority to obtain a grant under Sections 1065 and 1602 of the American Reinvestment and Recovery Act of 2009 (ARRA). Crete II was granted $4,315,360 under the Section 1602 program. The Section 1602 funds were used to assist in the financing of the acquisition and construction of the affordable housing building. These funds are subject to the Qualified Allocation Plan (QAP), the program requirements, and the terms and conditions of the written agreement, the mortgage note, the regulatory agreement, the provisions of Sections 1604 and 1602 of the ARRA, the guidelines, and any other rules, regulations, guidelines, and notices published by the U.S. Treasury or IRS from time to time with respect to the Section 1602 program that are applicable to the project. During the 15-year compliance period that ends on December 31, 2026, the project must meet occupant eligibility and unit gross rent, among other requirements. The amortization of deferred Section 1602 grant revenue totaled $288,000 for the years ended June 30, 2015 and 2014.

The Section 1602 grant funds are subject to recapture in the event of default by any noncompliance with the program requirements mentioned in the agreement, unless the noncompliance is cured within the stated time provided. For compliance purposes, this grant is also secured by a mortgage note that has a second lien on the property.

**9. Leases**

Addolorata Villa leases land under a ground lease with the Servants of Mercy, the original sponsor. The terms of the ground lease include an irrevocable option to purchase the land at a defined option price and an annual base rent of $1. Effective March 13, 2013, the termination date of the lease was extended to December 31, 2050.

**10. State of Indiana Intergovernmental Transfer Program**

Effective March 1, 2014, St. Anthony entered into a lease agreement with a county hospital, Hancock Regional Hospital (the "Hospital"), to lease the operations of the nursing facility (NF) and certain housing services (the "Convent") at St. Anthony to the Hospital (collectively, the operations of the NF and the Convent are referred to herein as the "Leased Property"). Concurrently, therewith, the Hospital entered into a management agreement between a newly-formed division of the Hospital, Hancock Regional Hospital (d/b/a St. Anthony Home - Crown Point) (SAH-CP), and a newly-formed division of Franciscan Communities, Inc. (d/b/a St. Anthony Management Services) (Management Services). Compensation to Management Services for management of the operations is provided as a percentage of net resident service revenue earned and certain fees. SAH-CP will reimburse St. Anthony for salaries, wages, and benefits of contracted labor provided to SAH-CP. Franciscan Communities entered into the lease agreement and the management agreement, as well as certain additional required agreements, in accordance with the requirements of participation in the State of Indiana's Intergovernmental Transfer (IGT) Program (the "Program"). In addition, St. Anthony was required to provide limited working capital to SAH-CP for the initial months of operation.

The Hospital, located in Greenfield, Indiana, is a county hospital, which is a primary requirement for participation for the Hospital and Franciscan Communities in the Program. Effective March 1, 2014 and thereafter, the operations of the Leased Property will be reported in the financial statements of the Hospital. Franciscan Communities, accordingly, reports the corresponding lease revenue and management services revenue under Management Services.

The operating lease related to the Leased Property was effective on March 1, 2014, is for an initial term of two (2) calendar years, and is renewable annually thereafter. Either party may terminate the lease, with or without cause, by providing a sixty (60) day written notice to the other party. The lease is expected to be renewed annually in the normal course of business. In accordance with guidelines established by the Centers for Medicare and Medicaid Services (CMS), the license for the NF was transferred to the Hospital as a result of the operating lease agreement.

## 10. State of Indiana Intergovernmental Transfer Program (continued)

Lease revenue amounted to $1,451,640 for the year ended June 30, 2015 and $483,880 for the four-month period ended June 30, 2014. The monthly base management services revenue and subordinated management services revenue amounted to $1,107,951 for the year ended June 30, 2015 and $458,435 for the four-month period ended June 30, 2014. The lease amount and the management services revenue are payable monthly to Franciscan Communities. In addition to the lease and management services revenue, Franciscan Communities is entitled to certain additional payments from the Hospital in accordance with the various agreements. At June 30, 2015 and 2014, the amount due of $1,778,192 and $2,163,507, respectively, was due to Franciscan Communities from the Hospital for revenue earned under the various agreements, including management services revenue, lease payments, payroll expense, and working capital advances and is included in prepaid expenses and other.

If there is any possibility, as reasonably determined by the Hospital, that net patient revenues and working capital are not sufficient to pay all operating expense, interest expense, rent, and fees for SAH-CP, Management Services will immediately notify the Hospital and present a plan to the Hospital for addressing the unfavorable results. The plan could include a temporary reduction in management services revenue or other amounts paid to Management Services. Such a plan may also be established by the Hospital, if it reasonably determines that net patient revenues and working capital are not sufficient to fund the payments described in the various agreements.

## 11. Endowment Funds

The Sisters established endowment funds with St. Jude House, Inc. and Madonna Foundation by contributing $2,000,000 and $2,500,000, respectively. In 2013, the Sisters contributed an additional $500,000 to the endowment fund of St. Jude House, Inc. Per the agreement between the Sisters and St. Jude House, Inc. and Madonna Foundation, contributions to the endowment funds are to exist in perpetuity with the income and appreciation available to support the operational programs and services to benefit the clients of St. Jude House, Inc. and the scholars of Madonna Foundation. Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

## 11. Endowment Funds (continued)

| | Internally Restricted | | Permanently Restricted | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Endowment funds: | | | | |
| Madonna Foundation | $ **3,037,358** | $ 3,114,892 | $ **-** | $ - |
| St. Jude House, Inc. | **2,658,350** | 2,649,849 | **-** | - |
| Other | **-** | - | **730,209** | 730,209 |
| Total funds | $ **5,695,708** | $ 5,764,741 | $ **730,209** | $ 730,209 |

Changes in endowment net assets consisted of the following for the fiscal years ended June 30:

| | Internally Restricted | | Permanently Restricted | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Endowment net assets, beginning of year | $ **5,764,741** | $ 5,500,967 | $ **730,209** | $ 730,209 |
| Investment return: | | | | |
| Investment income | **119,229** | 82,826 | **2,615** | 5,945 |
| Net income (realized and unrealized) | **304,112** | 441,177 | **4,056** | 32,159 |
| Total investment return | **423,341** | 524,003 | **6,671** | 38,104 |
| Net asset transfers to unrestricted net assets | **-** | - | **(6,671)** | (38,104) |
| Appropriation of endowment assets for expenditure | **(492,374)** | (260,229) | **-** | - |
| Endowment net assets, end of year | $ **5,695,708** | $ 5,764,741 | $ **730,209** | $ 730,209 |

## 11. Endowment Funds (continued)

### Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires Franciscan Ministries to retain as a fund or in perpetual duration. There were no deficiencies of donor-restricted endowment funds at June 30, 2015 and 2014.

## 12. Transactions with Affiliates

Notes payable to, and long-term arrangements with, affiliates consisted of the following at June 30:

| | 2015 | 2014 |
|---|---|---|
| Working capital loan agreement payable to the Franciscan Sisters of Chicago, Inc., due June 1, 2017, with monthly payments of principal and interest; interest rate 5.0% | **$ 5,205,091** | $ 5,412,626 |
| Less current maturities of note payable to affiliates | **217,384** | 207,477 |
| | **$ 4,987,707** | $ 5,205,149 |

On July 1, 2012, Franciscan Ministries entered into an unsecured promissory note payable with the Sisters in the amount of approximately $5,798,000. The term of the note is five years with a defined balloon payment subject to refinancing and bears interest at 5%. The note requires monthly payments of approximately $39,000.

On October 17, 2007, St. Joseph Housing entered into an unsecured working capital line-of-credit agreement with the Sisters. The agreement was effective November 1, 2007, in an amount not to exceed $5,000,000. On October 31, 2012, the Sisters extended the maturity date of the capital line-of-credit agreement with St. Joseph Housing until November 1, 2017. There are no advances under the working capital line-of-credit at June 30, 2015 and 2014.

Effective July 21, 2014, Franciscan Ministries entered into a license agreement with the Sisters to make available and share certain space on the first floor of Our Lady of Victory Convent to operate as assisted living. The license calls for an annual license fee of $1 and a prorata share of the operating costs. Total prorata share of operating expenses charged to operations under the agreement amounted to $200,000 for the year ended June 30, 2015.

## 12. Transactions with Affiliates (continued)

Effective February 1, 2015, Franciscan Ministries entered into a License Agreement with the Sisters to make available and share certain space in the Sisters' Administration Building to meet the office space needs of Franciscan Ministries. The License Agreement calls for an annual license fee of $1 and a prorata share of the operating costs of the building. Total expense charged to operations under the agreement amounted to $87,399 for the five-month period ended June 30, 2015.

As described in Note 1, Franciscan Ministries has land lease agreements with the Sisters to lease land at Franciscan Village and Marian Village, all of which expire on June 30, 2050. Under the terms of amendments to the ground leases, dated May 1, 2014, the annual rent is $1 per year effective July 1, 2014. Total rent expense charged to operations under these agreements amounted to $156,618 and $260,791 for each of the years ended June 30, 2015 and 2014. At June 30, 2015, the present value of the future contributed rent, net of amortized amounts, amounted to $5,481,540.

## 13. Employee Benefit Plans

### Medical Center Defined-Benefit Pension Plan

As of June 30, 1998, the defined-benefit pension plan was suspended.

The St. Anthony Medical Center, Inc. Retirement Plan (the "Plan") was amended effective March 31, 2012, in order to effectuate the termination and orderly liquidation of the Plan. The amendment states that benefits shall be provided from plan assets to the extent funded, and the accrued benefit of each participant shall be reduced in connection with the termination of the Plan, based upon the funded status of the Plan on the termination date, March 31, 2012. There were no financial instruments in the Plan as of June 30, 2015 or 2014.

## 13. Employee Benefit Plans (continued)

The summary of the changes in the benefit obligation and plan assets and the resulting funded status of the Plan are as follows at June 30:

| | 2015 | 2014 |
|---|---|---|
| Projected benefit obligation: | | |
| Benefit obligation at beginning of year | $ - | $ 460,000 |
| Benefits paid | - | (460,000) |
| Projected benefit obligation at end of year | $ - | $ - |
| Accumulated benefit obligation | $ - | $ - |
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | $ - | $ 460,000 |
| Benefits paid | - | (460,000) |
| Fair value of Plan assets at end of year | $ - | $ - |

### Franciscan Ministries 401(k) Defined-Contribution Plan

Franciscan Ministries sponsors a 401(k) defined-contribution plan covering substantially all eligible employees. Franciscan Ministries contributed an amount ranging from 1% to 2% of each eligible employee's compensation plus a match of 50% of employee contributions to a maximum employer contribution ranging from 3% to 4% in 2015 and 2014. Franciscan Ministries' total expenses related to the plan were $841,113 and $705,660 for the years ended June 30, 2015 and 2014, respectively, and are included in employee benefit expenses in the accompanying consolidated statements of operations and changes in net assets.

## 14. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets include net assets available for the purchase of assets and for specific programs totaling $2,124,460 and $1,578,716 at June 30, 2015 and 2014, respectively. Temporarily restricted net assets also include contributed land lease rights totaling $5,481,540 and $0 at June 30, 2015 and 2014, respectively.

## 14. Temporarily and Permanently Restricted Net Assets (continued)

Permanently restricted net assets have been restricted by donors to be maintained by Franciscan Ministries in perpetuity, the income from which is expendable to support purchases of capital, and amounted to $730,209 at both June 30, 2015 and 2014.

## 15. Functional Expenses

Franciscan Ministries provides comprehensive residential and healthcare services to residents within its geographic location. The expenses related to continuing operations included in the consolidated statements of operations and changes in net assets are primarily related to the following for the years ended June 30:

| | 2015 | 2014 |
|---|---|---|
| Nursing care | $ 66,554,927 | $ 69,793,845 |
| Senior housing | 36,192,294 | 35,282,584 |
| Education and community services | 1,556,711 | 2,087,271 |
| General and administrative | 27,472,736 | 24,816,701 |
| | $ 131,776,668 | $ 131,980,401 |

## 16. Commitments and Contingencies

### Internal Revenue Service Examination

In July 2009, the IRS notified Franciscan Ministries that it will examine Franciscan Ministries' 2007 tax return. The examination was later expanded to include the 2008 tax return and certain employee benefit issues. In January 2012, the IRS notified Franciscan Ministries that the tax returns were accepted; however, certain employee benefits issues are still under examination. Management has no estimate of potential liability, if any, at this time.

### Other Contingencies

Franciscan Ministries is a defendant in a class action lawsuit filed in conjunction with the termination of the Plan. Franciscan Ministries believes that the suit is without merit and intends to vigorously defend its position.

Franciscan Ministries is a defendant in various other legal actions that have arisen in the normal course of business. Franciscan Ministries believes that the eventual resolution of these claims will not have a material effect on Franciscan Ministries' financial position or operations.

## 17. Guarantees

Franciscan Ministries has agreed to provide an Operating Deficit Guarantee and Tax Credit Guarantee for Crete Senior Housing, LLC, which provides affordable senior housing in Crete, Illinois, on land owned by Franciscan Ministries. The Operating Deficit Guarantee is for a period of three years commencing with stabilization, which has not been met, limited to an amount equal to six months of operating expenses. The Operating Deficit Guarantee will be in the form of an operating loan bearing interest at 4% payable upon available cash flow. The Tax Credit Guarantee obligates Franciscan Ministries to reimburse the investor for losses (including interest and penalties) resulting from the recapture of low-income housing tax credits due to the project being operated in a manner inconsistent with the rent and affordability restrictions imposed by Section 42 of the Code. Tax credits will be guaranteed for five years from the issuance of 8609 tax certification. This guarantee would not become operative provided the residents occupying the building are within established income guidelines. The maximum aggregate amount that Franciscan Ministries shall be required to pay under the Operating Deficit Guarantee and the Tax Credit Guarantee is $512,740.

Franciscan Ministries has agreed to provide a Tax Credit Guarantee for Louisville Senior Housing, LLC, which provides affordable senior housing in Louisville, Kentucky. The Tax Credit Guarantee obligates Franciscan Ministries to reimburse the investor for losses (including interest and penalties) resulting from the recapture of low-income housing tax credits due to the project being operated in a manner inconsistent with the rent and affordability restrictions imposed by Section 42 of the Code. Tax credits will be guaranteed for five years from the issuance of 8609 tax certification. This guarantee would not become operative provided the residents occupying the building are within established income guidelines. The maximum aggregate amount that Franciscan Ministries shall be required to pay under the Operating Deficit Guarantee and the Tax Credit Guarantee is $823,850.

Franciscan Ministries has agreed to guarantee for Crete Senior Housing Phase II, LLC, which provides affordable senior housing in Crete, Illinois, on land owned by Franciscan Ministries, the payment of the recapture amount pursuant to the Section 1602 Grant documents and the payment of the repayment pursuant to the Home Program documents. The recapture amount under the Section 1602 Grant is eliminated over a 15-year compliance period. As of June 30, 2015 and 2014, the maximum amount due under the guarantee approximates $3,609,000 and $3,766,000, respectively, and is reported as Section 1602 Deferred Grant Revenue under noncurrent liabilities. This guarantee is not anticipated to be used as long as the residents occupying the building are within established income guidelines.

## 18. Self-Insurance Risks

Effective July 1, 2013, Franciscan Ministries is insured for workers' compensation through a fully funded insurance policy with normal statutory limit coverages in Indiana. Franciscan Ministries, prior to July 1, 2013, was self-insured for workers' compensation losses up to a maximum limit of $300,000 per occurrence in Indiana. Franciscan Ministries is self-insured for workers' compensation in Illinois and Kentucky up to a maximum limit of $450,000 per occurrence. Losses over these limits are covered by a supplemental catastrophic policy up to specified limits with an independent insurer. Estimated accruals for workers' compensation, which include estimates of the ultimate costs for is both reported claims and claims incurred but not yet reported, were $1,445,068 and $1,211,219, undiscounted, as of June 30, 2015 and 2014, respectively.

Franciscan Ministries provides employee health insurance to its employees through a self-insured program. The self-insured program, implemented July 1, 2009, includes a specific stop loss deductible of $200,000 per plan participant and an aggregate stop loss policy with a maximum benefit of $1,000,000. Franciscan Ministries reported insurance claim liabilities of $650,000 and $550,000 as of June 30, 2015 and 2014, respectively, included in accounts payable and employee benefits, and an aggregate stop loss receivable of $53,829 and $125,574 as of June 30, 2015 and 2014, respectively, which is included in prepaid expenses and other.

## 19. Discontinued Operations

On February 28, 2009, Franciscan Communities executed the sale of certain operating divisions. The operating divisions include Franciscan Health Care Center, George Davis Manor, St. Clare Healthcare Center, St. Elizabeth Healthcare Center, St. James Manor and Villas, and St. Mary Healthcare Center.

## 20. Community Commitment

The mission, values, and philosophy of Franciscan Ministries are reflected in the programs in place to provide care to the underprivileged population. Franciscan Ministries makes a major commitment to the community and residents in need by providing charity care to residents through the Gift of Care Program, sustaining significant amounts of unreimbursed costs by participation in the Medicaid program, and allocating significant resources to meet a number of community benefit needs identified.

The cost of providing charity care is calculated based upon the total cost to charge ratio based upon service line and payor class. The cost of the charity care amounted to $429,000 and $408,000 for the years ended June 30, 2015 and 2014, respectively.

**20. Community Commitment (continued)**

Unreimbursed costs represent the excess of resident care costs over Medicaid reimbursements. The amount of unreimbursed costs over Medicaid reimbursement is calculated based on allocated costs per resident day. Unreimbursed costs amounted to $5,145,000 and $4,388,000 for the years ended June 30, 2015 and 2014, respectively.

Franciscan Ministries addresses the spiritual needs of the community and those served through pastoral care services including, but not limited to, chapel services. The costs of these pastoral care services amounted to $1,311,000 and $1,161,000 for the years ended June 30, 2015 and 2014, respectively.

**21. Subsequent Events**

Franciscan Ministries evaluated events and transactions occurring subsequent to June 30, 2015 through November 6, 2015, the date of issuance of the consolidated financial statements. During this period, there were certain subsequent events requiring disclosure, which are described below.

The Service Corporation was named as the defendant in litigation associated with a breach of contract regarding a Support Agreement among the Service Corporation, the bond trustee, and a former banking relationship (the "Support Agreement") entered into in 2004. The Support Agreement provided for certain financial support from the Service Corporation to provide for a portion of the funding of the development of a former affiliate of the Service Corporation. On September 16, 2015, the Service Corporation was unsuccessful in defending the litigation. The decision of this litigation awarded damages against the Service Corporation to the bank amounting to $1,950,000, which has been accrued in the accompanying consolidated financial statements as of June 30, 2015. The expense is reported as nonoperating litigation settlements, net of settlements of other claims.

On August 14, 2015, Franciscan Communities entered into a construction contract to renovate the nursing home at Franciscan Village. The total contract price approximates $5,400,000 and the renovation period is estimated to be 14 months.

On September 9, 2015, Franciscan Communities entered into a construction contract to build a club house at Marian Village. The total contract price approximates $440,000 and the construction period is estimated to be four months.

# CONSOLIDATED FINANCIAL STATEMENTS

Franciscan Sisters of Chicago Service Corporation
and Subsidiaries
(d/b/a Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago)

Years Ended June 30, 2016 and 2015

With Reports of Independent Auditors

ADDENDUM 3

**Franciscan Sisters of Chicago Service Corporation and Subsidiaries**

**Consolidated Financial Statements**

**Years Ended June 30, 2016 and 2015**

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ADDENDUM 3

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# Independent Auditor's Report

To the Board of Directors
Franciscan Sisters of Chicago
Service Corporation and Subsidiaries

We have audited the accompanying consolidated financial statements of Franciscan Sisters of Chicago Service Corporation and Subsidiaries (d/b/a Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago) (Franciscan Ministries), which comprise the consolidated balance sheets as of June 30, 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 Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these 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.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these 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 audits 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 the auditor's 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, the auditor considers internal control relevant to the entity'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 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 consolidated financial statements.

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

***Emphasis of Matter***

As explained in Note 5, the consolidated financial statements include investments valued at approximately $25,800,000 and $7,500,000 at June 30, 2016 and 2015, respectively, whose fair values have been estimated by management in the absence of readily determinable market values. Management's estimates are based on information provided by the investment managers, American Realty Advisors, Martingale Asset Managment, L.P.; and Boston Common Asset Management, LLC. Our opinion is not modified with respect to this matter.



Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

To the Board of Directors
Franciscan Sisters of Chicago
Service Corporation and Subsidiaries

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Franciscan Sisters of Chicago Service Corporation and Subsidiaries (d/b/a Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago) as of June 30, 2016 and 2015, and the results of their operations and changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

November 8, 2016

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Balance Sheets

| | June 30 | |
|---|---|---|
| | **2016** | **2015** |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 18,192,485** | $ 20,136,208 |
| Assets limited as to use - externally designated under debt agreements | **1,093,592** | 939,675 |
| Accounts receivable, less allowances for uncollectible accounts of $1,604,250 and $2,528,630 in 2016 and 2015, respectively | **6,612,490** | 6,740,878 |
| Due from affiliates | **-** | 86,124 |
| Due from third-party payors | **181,675** | 227,777 |
| Prepaid expenses and other | **4,767,170** | 4,093,451 |
| Total current assets | **30,847,412** | 32,224,113 |
| Assets limited as to use, net of amounts required to meet current obligations: | | |
| Internally designated for capital improvements | **98,405,224** | 86,798,687 |
| Externally designated under debt agreements and letters of credit | **14,978,384** | 22,711,508 |
| | **113,383,608** | 109,510,195 |
| Deferred bond issuance costs | **4,517,556** | 4,712,008 |
| Long-term investments | **1,102,994** | 1,003,826 |
| Other long-term assets | **7,465,149** | 2,090,883 |
| Property and equipment, net | **163,882,732** | 162,664,520 |
| Total assets | **$ 321,199,451** | $ 312,205,545 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Balance Sheets (Continued)

| | June 30 | |
|---|---|---|
| | 2016 | 2015 |
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 17,157,688 | $ 16,216,221 |
| Accrued salaries and employee benefits | 7,170,225 | 6,943,889 |
| Due to affiliates | 324,217 | 485,857 |
| Due to third-party payors | 966,243 | 977,699 |
| Current maturities of long-term debt | 3,022,918 | 2,061,242 |
| Current maturities of note payable to affiliate | 229,214 | 217,384 |
| Refundable resident deposits and entrance fees | 5,122,347 | 5,658,681 |
| Total current liabilities | 33,992,852 | 32,560,973 |
| Noncurrent liabilities: | | |
| Long-term debt, less current maturities | 174,767,211 | 177,910,146 |
| Note payable to affiliate, less current maturities | 4,757,724 | 4,987,707 |
| Section 1602 deferred grant revenue | 3,452,289 | 3,609,211 |
| Refundable resident deposits and refundable and nonrefundable entrance fees | 72,508,555 | 71,310,609 |
| Asset retirement obligations and other | 1,827,624 | 1,674,807 |
| Total noncurrent liabilities | 257,313,403 | 259,492,480 |
| Total liabilities | 291,306,255 | 292,053,453 |
| Net assets: | | |
| Noncontrolling interests in subsidiaries | 2,743,564 | 3,106,139 |
| Net assets: | | |
| Unrestricted | 18,653,294 | 8,709,744 |
| Temporarily restricted | 7,766,129 | 7,606,000 |
| Permanently restricted | 730,209 | 730,209 |
| | 27,149,632 | 17,045,953 |
| Total net assets | 29,893,196 | 20,152,092 |
| Total liabilities and net assets | $ 321,199,451 | $ 312,205,545 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Statements of Operations and Changes in Net Assets

| | Years Ended June 30 | |
|---|---|---|
| | **2016** | **2015** |
| **Unrestricted revenues, gains, and other support** | | |
| Net resident service revenue, including amortization of entrance fees of $1,948,079 in 2016 and $1,646,312 in 2015 | **$ 116,982,939** | $ 114,748,715 |
| Contracted labor revenue | **9,786,465** | 9,503,703 |
| Lease revenue | **1,264,485** | 1,702,974 |
| Management services fee revenue | **624,262** | 974,537 |
| Other operating revenue | **4,816,372** | 4,578,671 |
| Total unrestricted revenues, gains, and other support | **133,474,523** | 131,508,600 |
| **Expenses** | | |
| Salaries and wages | **58,493,548** | 55,798,310 |
| Employee benefits | **12,711,476** | 10,976,116 |
| Agency | **49,630** | 142,599 |
| Purchased services - resident | **6,986,911** | 6,849,296 |
| Purchased services - general | **12,159,238** | 10,610,412 |
| Drugs, food, supplies, and other | **10,585,961** | 10,846,580 |
| Administrative, utilities, and insurance | **11,482,384** | 14,262,663 |
| Provision for uncollectible accounts | **750,372** | 1,184,884 |
| Interest | **8,853,685** | 8,906,527 |
| Depreciation and amortization | **12,379,486** | 12,199,281 |
| Total operating expenses | **134,452,691** | 131,776,668 |
| Loss from operations | **(978,168)** | (268,068) |
| **Nonoperating** | | |
| Realized investment income | **3,857,815** | 3,844,426 |
| Net change in unrealized losses on investments - trading portfolio | **(1,175,157)** | (1,031,661) |
| Gain on sale of Symbria, Inc. shares - see footnote 6 | **8,387,700** | – |
| Loss on refinancing of long-term debt | **–** | (65,073) |
| Litigation settlements | **–** | (724,066) |
| Contribution revenue and other | **155,609** | 123,918 |
| Total nonoperating | **11,225,967** | 2,147,544 |
| Revenues in excess of expenses | **10,247,799** | 1,879,476 |
| Revenues in excess of expenses allocated to noncontrolling interests | **362,575** | 655,192 |
| Revenues in excess of expenses allocated to Franciscan Sisters of Chicago Service Corporation | **10,610,374** | 2,534,668 |

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

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

| | Years Ended June 30 | |
|---|---|---|
| | 2016 | 2015 |
| **Other changes in unrestricted net assets** | | |
| Net change in unrealized losses on investments – other-than-trading portfolio | $ (175,664) | $ (205,129) |
| Net assets released from restrictions used for capital purposes | 8,840 | 60,950 |
| Transfers to affiliates | (500,000) | (500,000) |
| Total other changes in unrestricted net assets | (666,824) | (644,179) |
| Increase in unrestricted net assets | 9,943,550 | 1,890,489 |
| **Temporarily restricted net assets** | | |
| Contributions for specific programs and asset purchases | 655,878 | 1,049,470 |
| Contributions of land lease rights - Net | – | 5,481,540 |
| Net assets released from restrictions | (495,749) | (503,726) |
| Increase in temporarily restricted net assets | 160,129 | 6,027,284 |
| **Permanently restricted net assets** | | |
| Investment income | 2,304 | 6,671 |
| Transfers to unrestricted net assets | (2,304) | (6,671) |
| Change in permanently restricted net assets | – | – |
| Increase in net assets | 10,103,679 | 7,917,773 |
| **Changes in net assets of noncontrolling interest** | | |
| Net loss of noncontrolling interests in subsidiaries | (362,575) | (655,192) |
| Decrease in net assets of noncontrolling interests | (362,575) | (655,192) |
| Net increase in total net assets | 9,741,104 | 7,262,581 |
| Net assets at beginning of year | 20,152,092 | 12,889,511 |
| Net assets at end of year | $ 29,893,196 | $ 20,152,092 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Statements of Cash Flows

| | Years Ended June 30 | |
|---|---|---|
| | 2016 | 2015 |
| **Operating activities** | | |
| Increase in net assets | $ 9,741,104 | $ 7,262,581 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 12,379,486 | 12,199,281 |
| Amortization of entrance fees | (1,948,079) | (1,646,312) |
| Amortization of Section 1602 grants | (156,922) | (156,922) |
| Loss on refinancing of long-term debt | – | 65,075 |
| Loss on disposal of assets | 1,435 | 18,665 |
| Provision for uncollectible accounts | 750,372 | 1,184,884 |
| Restricted contributions, net of assets released from restrictions used for operations | (160,129) | (545,744) |
| Contribution of land lease rights - net | – | (5,481,540) |
| Reduction in contributed land lease rights | 156,616 | – |
| Net change in unrealized losses on investments | 1,350,821 | 1,236,790 |
| Gain on sale of shares of Symbria, Inc. | (8,387,700) | – |
| Transfer to affiliate | 500,000 | 500,000 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and due to/from third-party payors | (587,337) | (7,718) |
| Accounts payable, accrued salaries, prepaid expenses, deferred marketing costs, and other | (4,792,756) | 1,045,124 |
| Nonrefundable entrance fees | 1,749,863 | 1,904,869 |
| Due (from) to affiliate | (75,516) | 483,228 |
| Net cash provided by operating activities | 10,521,258 | 18,062,261 |
| **Investing activities** | | |
| Purchases of property and equipment, net, and other | (13,395,055) | (8,838,002) |
| Proceeds from sale of assets | – | 736 |
| Proceeds from sale of shares of Symbria, Inc. | 8,499,700 | – |
| Purchase of assets limited as to use and other investments - trading portfolio, net | (6,359,497) | (7,381,846) |
| Sales of assets limited as to use and other investments - other-than-trading portfolio, net | 732,652 | 447,864 |
| Net cash used in investing activities | (10,522,200) | (15,771,248) |
| **Financing activities** | | |
| Retirement of long-term debt | – | (1,466,280) |
| Payments of long-term debt | (2,181,258) | (2,162,261) |
| Payments on note payable to affiliate | (218,153) | (207,535) |
| Payment of bond issuance costs | – | (86,003) |
| Transfers to affiliates | (500,000) | (500,000) |
| Proceeds from refundable resident deposits | 11,220,599 | 10,731,733 |
| Refunds of resident deposits | (10,424,099) | (9,992,211) |
| Proceeds from restricted contributions and gains on investments, net of assets released from restrictions | 160,129 | 545,744 |
| Net cash used in financing activities | (1,942,782) | (3,136,813) |
| Decrease in cash and cash equivalents | (1,943,723) | (845,800) |
| Cash and cash equivalents at beginning of year | 20,136,208 | 20,982,008 |
| Cash and cash equivalents at end of year | $ 18,192,485 | $ 20,136,208 |

*See accompanying notes to consolidated financial statements.*



ADDENDUM 3

## 1. Organization and Summary of Significant Accounting Policies

### Organization and Basis of Presentation

Franciscan Sisters of Chicago Service Corporation and Subsidiaries, which is sponsored by the Franciscan Sisters of Chicago (the "Sisters"), is an Illinois not-for-profit corporation, which coordinates all of the Sisters' sponsored facilities and assists the Sisters in extending their charitable mission in health care and educational foundations in the Chicago metropolitan area, northern Indiana, Ohio, and Kentucky. Effective February 2015, Franciscan Sisters of Chicago Service Corporation began doing business as Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago (Franciscan Ministries).

The consolidated financial statements include the accounts and transactions of Franciscan Ministries (Service Corporation), Franciscan Communities, Inc. Obligated Group (Obligated Group), SAMC, Inc. (Medical Center), St. Joseph Senior Housing (St. Joseph Housing), Franciscan Community Services, Inc. (Community Services), Franciscan Community Benefit Services, Inc. (CBS), and Franciscan Advisory Services, Inc. (FAS). The operating divisions of CBS include Madonna Foundation and St. Jude House, Inc. The operating divisions of St. Joseph Housing include Crete Senior Housing I, LLC, Crete Senior Housing Phase II, LLC, and Louisville Senior Housing, LLC. The portion of Crete Senior Housing Phase II, LLC and Louisville Senior Housing, LLC not owned by St. Joseph Housing is reported as noncontrolling interest in the consolidated financial statements.

The members of the Obligated Group include Franciscan Communities, Inc. (Franciscan Communities) and University Place, Inc. Franciscan Communities includes the following operating divisions; Addolorata Villa, Franciscan Village, Marian Village, Mount Alverna Village (Mount Alverna), St. Anthony Home (St. Anthony), St. Anthony Management Services (Management Services), St. Joseph Village of Chicago (St. Joseph), and The Village at Victory Lakes (Victory Lakes).

Franciscan Ministries, the Obligated Group, Community Services, Medical Center, and CBS are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the "Code") and are not private foundations within the meaning of Section 509(a) of the Code. St. Joseph Housing is a tax-exempt organization under Section 501(c)(4) of the Code and is not a private foundation within the meaning of Section 509(a) of the Code.

A for-profit subsidiary of Franciscan Ministries, FAS was incorporated on June 16, 2011 with the purpose of managing certain ministries of the Sisters that did not meet the definition of the exempt purpose of Franciscan Ministries.

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

All significant intercompany transactions have been eliminated in consolidation.

### 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 at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time that the estimates are made, actual results could differ.

### Cash Equivalents

It is Franciscan Ministries' policy to reflect all investments that are not limited as to use and that have a maturity of three months or less at the time of acquisition as cash equivalents.

### Cash Concentration

Franciscan Ministries has cash on deposit with financial institutions, which at times may be in excess of federally insured limits.

### Assets Limited as to Use and Long-Term Investments

Assets limited as to use consist of investments set aside by the Board of Directors for future capital improvements, over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes. In addition, assets limited as to use include investments held by trustees under debt agreements and amounts as collateral for workers' compensation letters of credit.

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. Investment income is included in revenues in excess of expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses in the value of other-than-trading portfolio investments are recognized as changes in unrestricted net assets, while the unrealized gains and losses in the value of the trading portfolio investments are recognized as a nonoperating gain or loss.

Effective November 1, 2002, Franciscan Ministries established an investment pool. Investments of Franciscan Ministries held in the investment pool amounted to $95,249,555 and $82,734,701 at June 30, 2016 and 2015, respectively, and are included in assets limited as to use, internally designated for capital improvements on the accompanying consolidated balance sheets.

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

Franciscan Ministries' investments are exposed to various risks, such as interest rate, market, and credit risk. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in risks in the near term could materially affect the amounts reported in the consolidated balance sheets.

### Accounts Receivable

Accounts receivable for residents, insurance companies, and governmental agencies are based on net charges. Franciscan Ministries evaluates the collectibility of its accounts receivable based on the length of time the receivable is outstanding, payor class, and the anticipated future uncollectible amounts based on historical experience. Accounts receivable are charged to the allowance for uncollectible accounts when they are deemed uncollectible. Franciscan Ministries does not require collateral.

### Deferred Bond Issuance Costs

Expenses incurred in connection with the issuance of bonds are deferred and amortized over the lives of the bonds. Deferred bond issuance costs are stated net of accumulated amortization of $1,090,769 and $907,598 at June 30, 2016 and 2015, respectively.

### Property and Equipment

Property and equipment are stated on the basis of cost or, if donated to Franciscan Ministries, at fair value on the date of acquisition. Provisions for depreciation are computed using the straight-line method over the estimated useful lives of the assets ranging from three to 40 years.

Costs directly related to the acquisition, development, and improvement of real estate are capitalized, including interest and other costs incurred during the construction period. Costs incurred for significant repairs and maintenance that extend the usable life of the asset or have a determinable useful life are capitalized. Ordinary repairs and maintenance are expensed as incurred.

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

### Land Lease Rights

Franciscan Ministries has rights to lease from a related party 30.8 acres of land at Franciscan Village and 80.0 acres of land at Marian Village through June 30, 2050. Each of these leases call for annual payments of $1 throughout the term of the lease agreements. Franciscan Ministries has determined that the required lease payments are less than fair value and therefore has recorded the estimated fair value of future lease payments as land lease rights in property and equipment on the consolidated balance sheet and a contribution of land lease rights as a change in temporarily restricted net assets. The amounts totaled $5,324,924 and $5,481,540 at June 30, 2016 and 2015, respectively. Both balances are amortized as lease expense and an unrestricted contribution over the terms of the leases.

### Asset Retirement Obligations

Asset retirement obligations represent an obligation to dispose of assets that are legally required to be removed at a future date. Such obligations are recorded at the net present value using a risk-free interest rate and inflationary rate. As of June 30, 2016 and 2015, the asset retirement obligation for Franciscan Ministries was $507,085 and $492,315, respectively.

### Refundable Resident Deposits and Entrance Fees

Franciscan Ministries offers various independent living residency agreement options, including rental agreements and entrance fees with variable contract options, which include 90 percent refundable, 50 percent refundable, and fully amortizable programs.

Refundable resident deposits represent amounts received from prospective independent living residents, placing them on a priority list and making them eligible, once qualified, to receive certain resident benefits upon occupancy. A deposit of 10 percent of the entrance fee for the unit selected under the residency agreement makes the residents eligible to receive certain other benefits.

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

Upon a residents' occupancy, an entrance fee is reported as refundable to the extent the entrance fee is refundable to the resident according to the residency agreement. Nonrefundable entrance fees are reported as nonrefundable entrance fees. Nonrefundable entrance fees are amortized into revenue using the straight-line method based on the estimated life of the resident or contract term, if shorter. Franciscan Ministries may require entrance fees from assisted living residents. The entrance fees are refundable, in varying amounts, to the residents upon termination of the residency agreements. Total entrance fee amortization reported as net resident service revenue for the years ended June 30, 2016 and 2015 totaled $1,948,079 and $1,646,312, respectively.

Franciscan Ministries offers various entrance fee plans to prospective residents. Based upon the type of plan, Franciscan Ministries may have a financial obligation to provide future healthcare benefits to the residents. Management calculated the future service obligation at June 30, 2016 and 2015, and concluded that there is no liability as of June 30, 2016 and 2015.

### Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets include assets whose use has been limited by donors to a specific time period or purpose and contributed land lease rights. Permanently restricted net assets have been restricted by donors to be maintained by Franciscan Ministries and its related companies in perpetuity. Assets released from restrictions that are used for capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to unrestricted net assets. Assets released from restrictions that are used for operating purposes are reported in the consolidated statements of operations and changes in net assets as other operating revenue. Earnings on restricted net assets are recorded as temporarily restricted net assets until amounts are expended in accordance with donors' specifications.

### Contributions

Contributions are reported at fair value at the date of the contribution. Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost.

### Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. The gifts are reported as either temporarily or permanently restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets in the consolidated statements of operations and changes in net assets as net assets.

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

### Community Commitment

Franciscan Ministries provides care to residents who meet certain criteria without charge or at amounts less than established rates. Services to residents are classified as charity care in accordance with established criteria. Charity care represents services rendered for which partial payment is less than cost or no payment is expected and, as such, is not included in the net resident service revenue in the consolidated statements of operations and changes in net assets.

### Net Resident Service Revenue

Franciscan Ministries has agreements with third-party payors that provide for payments to Franciscan Ministries at amounts different from its established rates. Payment arrangements include prospectively determined rates, discounted charges, and per-diem payments. Net resident service revenue is reported at the estimated net realizable amounts from residents, third-party payors, and others for services rendered.

### Impairment of Long-Lived Assets

Franciscan Ministries considers whether indicators of impairment are present and performs the necessary tests in accordance with generally accepted accounting principles to determine if the carrying value of the asset is impaired. Impairment is recognized when estimated undiscounted operating income before depreciation and amortization is less than the carrying value of the property. To the extent that impairment has occurred, the excess of carrying value of the property over its estimated fair value is charged to operations. Impairment write-downs, if any, are reflected in loss from continuing operations. There was no impairment for the years ended June 30, 2016 and 2015.

### Revenues in Excess of Expenses

The consolidated statements of operations and changes in net assets include revenues in excess of expenses. Changes in unrestricted net assets, which are excluded from revenues in excess of expenses, include changes in the unrealized gains and losses on other-than-trading portfolio investments, transfers to affiliates, and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purpose of acquiring such assets).

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

### Federal Income Tax

Franciscan Ministries has analyzed the tax positions taken in its filings with the Internal Revenue Service (IRS) and state jurisdictions where it operates. Franciscan Ministries believes that its income tax filing positions will be sustained upon examination and does not anticipate any adjustments that would result in a material adverse effect on Franciscan Ministries' financial condition, results of operations, or cash flows. Accordingly, Franciscan Ministries has not recorded any reserves or related accruals for interest and penalties for uncertain income tax positions at June 30, 2016 and 2015.

### Accounting Standards Update

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), which will supersede the current revenue recognition requirements in Topic 605, *Revenue Recognition.* The ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The new guidance will be effective for Franciscan Ministries' year ending June 30, 2019. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods. Franciscan Ministries has not yet determined which application method they will use or the potential effects of the new standard on the consolidated financial statements, if any.

In February 2016, the Financial Accounting Standards Board issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statements of operations and changes in net assets. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for Franciscan Ministries' year ending June 30, 2020 and will be applied using a modified retrospective transition method to the beginning of the earliest period presented. The effect of applying the new lease guidance on the consolidated financial statements has not yet been determined.

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

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* in August 2016. ASU No. 2016-14 requires significant changes to the financial reporting model of organizations who follow FASB not-for-profit rules, including changing from three classes of net assets to two classes, net assets with donor restrictions and net assets without donor restrictions. The ASU will also require changes in the way certain information is aggregated and reported by Franciscan Ministries, including required disclosures about the liquidity and availability of resources. The new standard is effective for Franciscan Ministries' year ending June 30, 2019 and thereafter and must be applied on a retrospective basis. Franciscan Ministries is currently evaluating the impact this standard will have on the consolidated financial statements.

## 2. Contractual Arrangements with Third-Party Payors

Franciscan Ministries provides care to certain residents under payment arrangements with Medicare, Medicaid, and various health maintenance and preferred provider organizations. Services provided under these arrangements are paid at predetermined rates and/or per-diem rates, as defined. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, and as a result, there is a possibility that recorded estimates may change.

Amounts received under Medicare and Medicaid payment arrangements accounted for 31 percent and 34 percent of Franciscan Ministries' net resident service revenue in 2016 and 2015, respectively. Medicare and Medicaid accounts receivable accounted for 56 percent and 62 percent of Franciscan Ministries' net accounts receivable at June 30, 2016 and 2015, respectively.

Provision has been made in the consolidated financial statements for estimated contractual adjustments, recorded in net resident revenue in the consolidated statements of operations and changes in net assets, representing the difference between Franciscan Ministries' standard charges for services and the estimated payments to be received from the third-party payors.

## 3. Entrance Fees and Deposits

Franciscan Ministries may require security deposits of various amounts from private pay residents at the time of admission for nursing care. The security deposits are fully refundable to the residents upon discharge from a community. The security deposits are included in current liabilities and reported as refundable resident deposits and entrance fees. The security deposits amounted to $640,302 and $638,382 at June 30, 2016 and 2015, respectively.

### 3. Entrance Fees and Deposits (continued)

Franciscan Ministries requires entrance fees from assisted living residents. The refundable portion of the entrance fees varies by community and is refundable to the resident upon discharge from the community. The refundable portion of the entrance fees is included in current liabilities and reported as refundable resident deposits and entrance fees. The nonrefundable portion of the entrance fee is included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $782,119 and $911,162 at June 30, 2016 and 2015, respectively. The nonrefundable portion of these entrance fees amounted to $172,431 and $281,702 at June 30, 2016 and 2015, respectively.

Prospective independent living residents are subject to reservation deposits up to a maximum of 10 percent of the entrance fee for the unit selected under the residency agreements, making the residents eligible to receive certain other benefits. Upon occupancy, the resident is charged the remaining 90 percent of the entrance fee. The reservation deposits are fully refundable if the contract is terminated prior to occupancy, and they are included in current liabilities and reported as refundable resident deposits and entrance fees. Reservation deposits amounted to $255,223 and $222,751 at June 30, 2016 and 2015, respectively.

Franciscan Ministries requires entrance fees, in varying amounts, in certain independent living residency agreements. Under the terms of these residency agreements, the amount of the refundable portion varies and is refundable upon termination of the residency agreements. The refundable portion of the entrance fee is included in current liabilities and reported as refundable resident deposits and entrance fees. The nonrefundable portion is included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $3,444,703 and $3,886,385 at June 30, 2016 and 2015, respectively. The nonrefundable portion of these entrance fees amounted to $327,169 and $337,563 at June 30, 2016 and 2015, respectively.

### 3. Entrance Fees and Deposits (continued)

Franciscan Ministries also requires entrance fees, in varying amounts, under other independent living residency agreements. Under the terms of these residency agreements, the amount of the refundable portion varies and is refundable upon termination, reoccupancy of the vacated unit, and leaving the community before amounts are required to be refunded. The refundable and nonrefundable portions of the entrance fees are included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $66,456,578 and $64,982,232 at June 30, 2016 and 2015, respectively. The nonrefundable portion of these entrance fees amounted to $5,552,377 and $5,709,113 at June 30, 2016 and 2015, respectively.

### 4. Investments and Other Financial Instruments

Total investment return for the years ended June 30 is summarized as follows:

| | 2016 | 2015 |
|---|---|---|
| Dividend and interest income | **$ 2,551,305** | $ 1,809,264 |
| Realized gains | **1,835,527** | 2,492,928 |
| Investment fees | **(414,485)** | (350,451) |
| Unrealized losses | **(1,350,821)** | (1,236,790) |
| | **$ 2,621,526** | $ 2,714,951 |

As reported:

| | 2016 | 2015 |
|---|---|---|
| Other operating revenue | **$ 114,532** | $ 107,315 |
| Nonoperating: | | |
| Net investment income | **3,857,815** | 3,844,426 |
| Net change in unrealized losses on investments - trading portfolio | **(1,175,157)** | (1,031,661) |
| Other changes in unrestricted net assets - | | |
| Net change in unrealized gains/losses on investments - other-than-trading portfolio | **(175,664)** | (205,129) |
| | **$ 2,621,526** | $ 2,714,951 |

## 5. Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement and Disclosures,* establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of input that may be used to measure fair value:

- Level 1: Quoted prices (unadjusted) for identical assets in active markets that the entity has the ability to access as of the measurement date. The fair values of debt and equity investments that are readily marketable are determined by obtaining quoted prices on nationally recognized securities exchanges.

- Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data

- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy.

## 5. Fair Value Measurements (continued)

### Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below as of June 30, 2016:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Internally designated investments: | | | | |
| Franciscan Ministries Investment Pool: | | | | |
| Equities - domestic | $ 27,465,281 | $ 21,698,335 | $ 4,134,093 | $ 53,297,709 |
| Equities - international | 611,596 | - | - | 611,596 |
| Mutual fund - fixed income | 32,007,283 | 3,355 | - | 32,010,638 |
| Cash and cash equivalents | 9,329,612 | - | - | 9,329,612 |
| Total Franciscan Ministries Investment Pool | 69,413,772 | 21,701,690 | 4,134,093 | 95,249,555 |
| Fixed income | 3,155,669 | - | - | 3,155,669 |
| Total internally designated investments | 72,569,441 | 21,701,690 | 4,134,093 | 98,405,224 |
| Externally designated investments: | | | | |
| Fixed income | - | 10,130,568 | - | 10,130,568 |
| Cash and cash equivalents | 5,941,408 | - | - | 5,941,408 |
| Total externally designated investments | 5,941,408 | 10,130,568 | - | 16,071,976 |
| Long-term investments: | | | | |
| Pooled equity funds | 1,102,994 | - | - | 1,102,994 |
| | $ 79,613,843 | $ 31,832,258 | $ 4,134,093 | $ 115,580,194 |

## 5. Fair Value Measurements (continued)

Assets measured at fair value on a recurring basis are summarized below as of June 30, 2015:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Internally designated investments: | | | | |
| Franciscan Ministries Investment Pool: | | | | |
| Equities - domestic | $ 31,453,316 | $ 7,576,432 | $ - | $ 39,029,748 |
| Equities - international | 1,020,393 | - | - | 1,020,393 |
| Equities - mutual funds | 5,068,357 | - | - | 5,068,357 |
| Mutual fund - fixed income | 30,492,062 | 3,896 | - | 30,495,958 |
| Cash and cash equivalents | 7,120,245 | - | - | 7,120,245 |
| Total Franciscan Ministries Investment Pool | 75,154,373 | 7,580,328 | - | 82,734,701 |
| Fixed income | 4,063,986 | - | - | 4,063,986 |
| Total internally designated investments | 79,218,359 | 7,580,328 | - | 86,798,687 |
| Externally designated investments: | | | | |
| Fixed income | - | 11,736,537 | - | 11,736,537 |
| Cash and cash equivalents | 11,914,646 | - | - | 11,914,646 |
| Total externally designated investments | 11,914,646 | 11,736,537 | - | 23,651,183 |
| Long-term investments: | | | | |
| Pooled equity funds | 1,003,826 | - | - | 1,003,826 |
| | $ 92,136,831 | $ 19,316,865 | $ - | $ 111,453,696 |

Fair value for Level 1 assets is based on quoted market prices. Level 2 investments are valued by pricing services utilized by Franciscan Ministries' investment managers in which quoted market prices for similar instruments in active markets are used to determine fair value.

As of June 30, 2016 and 2015, there are no liabilities measured at fair value on a recurring basis.

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses are reasonable estimates of their fair value due to the short-term nature of those financial instruments. The carrying values of certain retirement liabilities related to deferred compensation plans are reasonable estimates of their fair value as they equate the fair value of the assets held within the deferred compensation plan.

It is not practicable to estimate the fair values of amounts due to/from affiliates, as timing of future cash flows is uncertain and/or the debtors' ability to borrow with similar terms from an unrelated party cannot be determined.

Franciscan Ministries' policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the actual date of the event of change in circumstances that caused the transfer. There were no transfers between levels at June 30, 2016 and 2015.

## 5. Fair Value Measurements (continued)

### Investments in Entities that Calculate Net Asset Value per Share

Franciscan Ministries holds shares or interests in investment companies within the investment pool at year end whereby the fair value of the investment held is estimated based on net asset value per share (or its equivalent) of the investment companies.

At year end, the fair value, unfunded commitments, and redemption rules of these investments is as follows:

| Fund | 2016 Fair Value | 2015 Fair Value | Unfunded Commitments | Redemption Frequency | Redemption Notice Period |
|---|---|---|---|---|---|
| Boston Common International Catholic SRI Fund | $ 7,582,625 | $ 7,576,432 | $ - | No Restriction | 30 days |
| Martingale Investment Trust | 14,115,710 | - | - | No Restriction | 10 days |
| American Core Realty Fund, LP | 4,134,093 | - | 870,000 | Quarterly | 10 days |

The Boston Common International Catholic SRI Fund includes a diversified portfolio of non-U.S. stocks of high-quality companies with the objective of achieving long-term capital appreciation.

The Martingale Investment Trust *Series 1: U.S. Low Volatility LargeCap* + employs a low volatility equity strategy with the objective of earning equity market returns over the long term with lower volatility than the market index. The underlying investments consist of U.S. large cap equity securities, exchange traded funds, and cash equivalents.

The American Core Realty Fund, LP is an open-end real estate investment fund that invests directly and/or indirectly through joint ventures, partnerships, and other participations with others, including senior and subordinate debt investments, generally in stable, institutional quality office and retail, industrial, and multifamily residential properties that generally are substantially leased with minimal deferred maintenance or functional obsolescence.

**5. Fair Value Measurements (continued)**

Changes in Level 3 assets measured at fair value on a recurring basis for the year ended June 30, 2016 is as follows:

| | American Core Realty Fund, LP |
|---|---|
| Balance at July 1, 2015 | $ - |
| Purchases | 4,130,000 |
| Unrealized gains | 35,214 |
| Realized losses | (7,624) |
| Net settlements and fees | (23,497) |
| Balance at June 30, 2016 | $ 4,134,093 |

The fair value of the American Core Realty Fund, LP at June 30, 2016 was determined primarily based on Level 3 inputs. Franciscan Ministries estimates the fair value of this investment based on the most recent investment statement provided for the fund.

Both observable and unobservable inputs may be used to determine the fair value of the positions classified as Level 3 assets. As a result, the unrealized gains for this asset presented in the table above may include changes in fair values that were attributable to both observable and unobservable inputs.

**6. Symbria, Inc.**

In October 2015, Franciscan Ministries sold its shares of Symbria, Inc. to the Symbria, Inc. Employees Stock Ownership Trust. Prior to October 2015, Franciscan Ministries had accounted for the investment in Symbria using the cost method. As a result of the sale, the following consideration was received: $3,162,570 in cash, $6,337,130 in an interest-bearing unsecured note, and 64,103 unexercised warrant shares. The interest-bearing note is subject to certain clawback provisions. In the event Symbria fails to meet agreed-upon projected earnings on a cumulative basis for the period beginning on April 1, 2015 and ending on March 31, 2018, the ESOP purchase price in the aggregate shall be reduced by the amount of any shortfall in earnings multiplied by 8.5 (the "Clawback"). Franciscan Ministries has recorded a $1,000,000 valuation against the interest-bearing note for the maximum amount of the Clawback attributable based on the shares of Symbria, Inc. held at the sale date. Franciscan Ministries did not record any amounts related to the warrant shares as the strike price of the warrants is comparable to the current market value of shares of Symbria, Inc. Employees Stock Ownership Trust. As of June 30, 2016 the subordinated note receivable plus accrued interest totaling $5,450,801 is recorded in the consolidated balance sheets as other long-term assets. As a result of the sale, Franciscan Ministries recognized $8,387,700 in realized gains in the consolidated statements of operations and changes in net assets for the year ended June 30, 2016.

### 7. Property and Equipment

Property and equipment are as follows at June 30:

| | 2016 | 2015 |
|---|---|---|
| Land and land improvements | **$41,950,006** | $41,473,172 |
| Land lease rights | **5,324,924** | 5,481,540 |
| Building and improvements | **251,913,194** | 246,994,107 |
| Furniture and moveable equipment | **35,131,562** | 34,195,856 |
| Construction in progress | **7,538,348** | 2,411,846 |
| | **341,858,034** | 330,556,521 |
| Less accumulated depreciation | **(177,975,302)** | (167,892,001) |
| | **$163,882,732** | $162,664,520 |
| | | |
| Depreciation expense | **$12,018,787** | $11,778,943 |

## 8. Long-Term Debt

Long-term debt consisted of the following at June 30:

| | 2016 | 2015 |
|---|---|---|
| Illinois Finance Authority Revenue Bonds: | | |
| Series 2004B, principal payable in varying annual installments from 2026 through 2034; interest rate 6.50% | **$ 3,060,000** | $ 3,060,000 |
| Series 2007A, principal payable in varying annual installments from 2013 through 2037; interest rates ranging from 5.25% to 5.50% | **40,120,000** | 40,140,000 |
| Series 2013A, principal payable in varying annual installments from 2014 through 2047; interest rate ranging from 2.15% to 5.25% | **95,830,000** | 97,330,000 |
| Series 2013B, principal payable in varying monthly installments from 2013 through 2043; interest rates vary monthly based on prevailing market conditions (2.28% and 2.10% at June 30, 2016 and 2015, respectively) | **10,461,829** | 10,700,101 |
| The Huntington National Bank: | | |
| Series 2013C, principal payable in varying monthly installments from 2013 through 2043; interest rates vary monthly based on prevailing market conditions (3.01% and 2.74% at June 30, 2016 and 2015, respectively) | **15,261,689** | 15,634,773 |
| County of Cuyahoga, Ohio Healthcare Facilities Revenue Bonds: | | |
| Series 2004C, principal payable in varying annual installments from 2028 through 2032; interest rate 6.25% | **5,255,000** | 5,255,000 |
| Series 2004D, principal payable in varying annual installments from 2033 through 2034; interest rate 6.50% | **2,745,000** | 2,745,000 |
| Illinois Housing Development Authority Mortgage Note, interest at 3.75%, principal due 2049; interest paid monthly | **2,330,521** | 2,363,208 |

**8. Long-Term Debt (continued)**

| | 2016 | 2015 |
|---|---|---|
| Illinois Housing Development Authority Mortgage Note, interest-only payments through 2017, principal due 2047; interest paid monthly; interest rate 1.0% | **$ 1,111,000** | $ 1,111,000 |
| Illinois Housing Development Authority Mortgage Note, principal due 2047; interest rate 6.08% | **1,615,090** | 1,632,306 |
| | **177,790,129** | 179,971,388 |
| Less current maturities of long-term debt | **3,022,918** | 2,061,242 |
| | **$174,767,211** | $177,910,146 |

Annual maturities of long-term debt and sinking fund requirements as of June 30, 2016, for each of the next five years, are as follows:

| | |
|---|---|
| 2017 | $ 3,022,918 |
| 2018 | 3,106,275 |
| 2019 | 3,232,574 |
| 2020 | 3,387,999 |
| 2021 | 3,476,112 |
| Thereafter | 161,564,251 |

**8. Long-Term Debt (continued)**

The maturity of the Series 2013B Bonds will be May 15, 2043, and the stated due date of the Taxable Term Loan is January 5, 2023. Despite the nominal maturity date of the Series 2013B Bonds, the commitment of the holder of the Series 2013B bonds expires on January 5, 2023, at which time the Series 2013B Bonds may be subject to mandatory purchase by the Obligated Group. In addition, if the Obligated Group defaults under the Taxable Term Loan, The Huntington National Bank (the "Bank") may elect to accelerate the maturity of the Taxable Term Loan. If such events occur, the Obligated Group would be required to refinance such indebtedness at that time.

Under the terms of the long-term debt arrangements, various amounts are on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The terms of certain long-term debt agreements also grant a security interest in the Obligated Group's gross revenues. In addition, the indenture restricts the Obligated Group from encumbering substantially all of its property, limits additional indebtedness, and requires maintenance of various financial ratios. The Obligated Group has Mortgage and Security Agreements and Leasehold Mortgage and Security Agreements, dated March 13, 2013, with the Master Trustee and the Bank as security for the Taxable Term Loan, providing substantially all property, plant, and equipment, and certain other assets as collateral, subject to the terms of certain ground leases.

Crete Senior Housing, LLC has a secured first mortgage in the property with the Illinois Housing Development Authority in the amount of $1,632,306 and a second secured mortgage note in the amount of $1,111,000. Crete Senior Housing Phase II, LLC has a secured mortgage in the property with the Illinois Housing Development Authority in the amount of $2,363,208. Effective October 2, 2014, Louisville Senior Housing, LLC entered into a secured mortgage note with Franciscan Ministries in the amount of $1,799,733. The loan is amortized over 35 years with an interest rate of 4.00 percent and with a balloon payment due May 2030. Monthly principal and interest on the loan total $7,969. Franciscan Ministries has a secured first mortgage in the property. The proceeds of the loan were used to retire the U.S. Bank National Association mortgage note and pay certain costs of issuance of the loan.

Interest paid on long-term debt amounted to $8,916,816 and $8,962,989 in 2016 and 2015, respectively.

Interest was capitalized in the amount of $69,556 and $60,363 during the years ended June 30, 2016 and 2015, respectively.

## 8. Long-Term Debt (continued)

The estimated fair value of long-term debt based on quoted market prices for the same or similar issues was $8,524,417 and $2,670,940 more than its carrying value at June 30, 2016 and 2015, respectively. Based on the inputs in determining the estimated fair values of the debt, this liability would be considered a Level 2 input within the fair value hierarchy.

The provisions of the Master Trust Indenture and the Taxable Term Loan as described above contain various restrictive covenants that limit the occurrence of additional debt and require certain measures of financial performance be satisfied as long as the bonds and Taxable Bank Loan are outstanding. Failure to maintain compliance could result in acceleration of payment for debt outstanding under the Master Trust Indenture and Taxable Term Loan. Management believes Franciscan Ministries is in compliance with such covenants at June 30, 2016 and 2015.

## 9. Grant Agreements

Crete Senior Housing Phase II, LLC (Crete II) has entered into a Section 1602 written agreement with the Illinois Housing Development Authority to obtain a grant under Sections 1065 and 1602 of the American Reinvestment and Recovery Act of 2009 (ARRA). Crete II was granted $4,315,360 under the Section 1602 program. The Section 1602 funds were used to assist in the financing of the acquisition and construction of the affordable housing building. These funds are subject to the Qualified Allocation Plan (QAP), the program requirements, and the terms and conditions of the written agreement, the mortgage note, the regulatory agreement, the provisions of Sections 1604 and 1602 of the ARRA, the guidelines, and any other rules, regulations, guidelines, and notices published by the U.S. Treasury or IRS from time to time with respect to the Section 1602 program that are applicable to the project. During the 15-year compliance period that ends on December 31, 2026, the project must meet occupant eligibility and unit gross rent, among other requirements. The amortization of deferred Section 1602 grant revenue totaled $156,922 for the years ended June 30, 2016 and 2015.

The Section 1602 grant funds are subject to recapture in the event of default by any noncompliance with the program requirements mentioned in the agreement, unless the noncompliance is cured within the stated time provided. For compliance purposes, this grant is also secured by a mortgage note that has a second lien on the property.

## 10. Leases

Addolorata Villa leases land under a ground lease agreement with the Servants of Mary, the original sponsor. The terms of the ground lease include an irrevocable option to purchase the land at a defined option price and an annual base rent of $1. Effective March 13, 2013, the termination date of the lease was extended to December 31, 2050.

## 11. State of Indiana Intergovernmental Transfer Program

Effective March 1, 2014, St. Anthony entered into a lease agreement with a county hospital, Hancock Regional Hospital (the "Hospital"), to lease the operations of the nursing facility (NF) and certain housing services (the "Convent") at St. Anthony to the Hospital (collectively, the operations of the NF and the Convent are referred to herein as the "Leased Property"). Concurrently, therewith, the Hospital entered into a management agreement between a newly-formed division of the Hospital, Hancock Regional Hospital (d/b/a St. Anthony Home - Crown Point) (SAH-CP), and a newly-formed division of Franciscan Communities, Inc. (d/b/a St. Anthony Management Services) (Management Services). Compensation to Management Services for management of the operations is provided as a percentage of net resident service revenue earned and certain fees. SAH-CP will reimburse St. Anthony for salaries, wages, and benefits of contracted labor provided to SAH-CP. Franciscan Communities entered into the lease agreement and the management agreement, as well as certain additional required agreements, in accordance with the requirements of participation in the State of Indiana's Intergovernmental Transfer (IGT) Program (the "Program"). In addition, St. Anthony was required to provide limited working capital to SAH-CP for the initial months of operation.

The Hospital, located in Greenfield, Indiana, is a county hospital, which is a primary requirement for participation for the Hospital and Franciscan Communities in the Program. Effective March 1, 2014 and thereafter, the operations of the Leased Property will be reported in the financial statements of the Hospital. Franciscan Communities, accordingly, reports the corresponding lease revenue and management services revenue under Management Services.

The operating lease related to the Leased Property was effective on March 1, 2014, is for an initial term of two (2) calendar years, and is renewable annually thereafter. Either party may terminate the lease, with or without cause, by providing a sixty (60) day written notice to the other party. The lease is expected to be renewed annually in the normal course of business. In accordance with guidelines established by the Centers for Medicare and Medicaid Services (CMS), the license for the NF was transferred to the Hospital as a result of the operating lease agreement.

## 11. State of Indiana Intergovernmental Transfer Program (continued)

Lease revenue amounted to $1,191,024 and $1,451,640 for the years ended June 30, 2016 and 2015, respectively. The monthly base management services revenue and subordinated management services revenue amounted to $0 and $1,107,951 for the years ended June 30, 2016 and 2015, respectively. The lease amount and the management services revenue are payable monthly to Franciscan Communities. In addition to the lease and management services revenue, Franciscan Communities is entitled to certain additional payments from the Hospital in accordance with the various agreements. At June 30, 2016 and 2015, the amount due of $1,063,691 and $1,778,192, respectively, was due to Franciscan Communities from the Hospital for revenue earned under the various agreements, including management services revenue, lease payments, payroll expense, and working capital advances and is included in prepaid expenses and other.

If there is any possibility, as reasonably determined by the Hospital, that net patient revenues and working capital are not sufficient to pay all operating expense, interest expense, rent, and fees for SAH-CP, Management Services will immediately notify the Hospital and present a plan to the Hospital for addressing the unfavorable results. The plan could include a temporary reduction in management services revenue or other amounts paid to Management Services. Such a plan may also be established by the Hospital, if it reasonably determines that net patient revenues and working capital are not sufficient to fund the payments described in the various agreements.

## 12. Endowment Funds

The Sisters established endowment funds with St. Jude House, Inc. and Madonna Foundation by contributing $2,000,000 and $2,500,000, respectively. In 2013, the Sisters contributed an additional $500,000 to the endowment fund of St. Jude House, Inc. Per the agreement between the Sisters and St. Jude House, Inc. and Madonna Foundation, contributions to the endowment funds are to exist in perpetuity with the income and appreciation available to support the operational programs and services to benefit the clients of St. Jude House, Inc. and the scholars of Madonna Foundation. Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

**12. Endowment Funds (continued)**

| | Internally Restricted | | Permanently Restricted | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Endowment funds: | | | | |
| Madonna Foundation | $2,980,149 | $3,037,358 | $ - | $ - |
| St. Jude House, Inc. | 2,542,547 | 2,658,350 | - | - |
| Other | - | - | 730,209 | 730,209 |
| Total funds | $5,522,696 | $5,695,708 | $730,209 | $730,209 |

Changes in endowment net assets consisted of the following for the fiscal years ended June 30:

| | Internally Restricted | | Permanently Restricted | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Endowment net assets, beginning of year | $5,695,708 | $5,764,741 | $730,209 | $730,209 |
| Investment return: | | | | |
| Investment income | 92,180 | 119,229 | 2,250 | 2,615 |
| Net income (realized and unrealized) | 578 | 304,112 | 54 | 4,056 |
| Total investment return | 92,758 | 423,341 | 2,304 | 6,671 |
| Net asset transfers to unrestricted net assets | - | - | (2,304) | (6,671) |
| Appropriation of endowment assets for expenditure | (265,770) | (492,374) | - | - |
| Endowment net assets, end of year | $5,522,696 | $5,695,708 | $730,209 | $730,209 |

**Funds with Deficiencies**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires Franciscan Ministries to retain as a fund or in perpetual duration. There were no deficiencies of donor-restricted endowment funds at June 30, 2016 and 2015.

### 13. Transactions with Affiliates

Notes payable to, and long-term arrangements with, affiliates consisted of the following at June 30:

| | 2016 | 2015 |
|---|---|---|
| Working capital loan agreement payable to the Franciscan Sisters of Chicago, Inc., due June 1, 2022, with monthly payments of principal and interest; interest rate 5.0% | $ 4,986,938 | $ 5,205,091 |
| Less current maturities of note payable to affiliates | 229,214 | 217,384 |
| | $ 4,757,724 | $ 4,987,707 |

On July 1, 2012, Franciscan Ministries entered into an unsecured promissory note payable with the Sisters in the amount of approximately $5,798,000. The term of the note is five years with a defined balloon payment subject to refinancing and bears interest at 5 percent. The note requires monthly payments of approximately $39,000.

On October 1, 2016, the Service Corporation entered into an unsecured promissory note payable, effective June 1, 2017, with the Sisters to replace the working capital loan agreement payable to the Sisters due June 1, 2017. The note, in the amount of $4,778,367, representing the working capital loan agreement balance at June 1, 2017, has a term of five years with a defined balloon payment subject to refinancing and bears interest at 4 percent. The note will require monthly payments of approximately $35,500.

On October 17, 2007, St. Joseph Housing entered into an unsecured working capital line of credit agreement with the Sisters. The agreement was effective on November 1, 2007 in an amount not to exceed $5,000,000. On October 31, 2012, the Sisters extended the maturity date of the capital line of credit agreement with St. Joseph Housing until November 1, 2017. There are no advances under the working capital line-of-credit at June 30, 2016 and 2015.

Effective July 21, 2014, Franciscan Ministries entered into a license agreement with the Sisters to make available and share certain space on the first floor of Our Lady of Victory Convent to operate as assisted living. The license calls for an annual license fee of $1 and a pro-rata share of the operating costs. Total pro-rata share of operating expenses charged to operations under the agreement amounted to $178,573 and $200,000, for the years ended June 30, 2016 and June 30, 2015, respectively.

### 13. Transactions with Affiliates (continued)

Effective February 1, 2015, Franciscan Ministries entered into a License Agreement with the Sisters to make available and share certain space in the Sisters' Administration Building to meet the office space needs of Franciscan Ministries. The License Agreement calls for an annual license fee of $1 and a pro-rata share of the operating costs of the building. Total expense charged to operations under the agreement amounted to $107,507 for the year ended June 30, 2016 and $87,399 for the five-month period ended June 30, 2015.

As described in Note 1, Franciscan Ministries has land lease agreements with the Sisters to lease land at Franciscan Village and Marian Village, all of which expire on June 30, 2050. Under the terms of amendments to the ground leases, dated May 1, 2014, the annual rent is $1 per year, effective July 1, 2014. Total rent expense charged to operations under these agreements amounted to $156,618 for each of the years ended June 30, 2016 and 2015. At June 30, 2016 and June 30, 2015, the present value of the future contributed rent, net of amortized amounts, amounted to $5,324,924 and $5,481,540, respectively.

### 14. Employee Benefit Plans

Franciscan Ministries sponsors the Franciscan Ministries 401(k) Defined-Contribution Plan covering substantially all eligible employees. Franciscan Ministries contributed a match of 50 percent of employee contributions to a maximum employer contribution of 3 percent in 2016 and 2015. Franciscan Ministries' total expenses related to the plan were $934,806 and $841,113 for the years ended June 30, 2016 and 2015, respectively, and are included in employee benefit expenses in the accompanying consolidated statements of operations and changes in net assets.

### 15. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets include net assets available for the purchase of assets and for specific programs totaling $2,441,205 and $2,124,460 at June 30, 2016 and 2015, respectively. Temporarily restricted net assets also include contributed land lease rights totaling $5,324,924 and $5,481,540 at June 30, 2016 and 2015, respectively.

Permanently restricted net assets have been restricted by donors to be maintained by Franciscan Ministries in perpetuity, the income from which is expendable to support purchases of capital, and amounted to $730,209 at both June 30, 2016 and 2015.

## 16. Functional Expenses

Franciscan Ministries provides comprehensive residential and healthcare services to residents within its geographic location. The expenses related to continuing operations included in the consolidated statements of operations and changes in net assets are primarily related to the following for the years ended June 30:

| | 2016 | 2015 |
|---|---|---|
| Nursing care | $66,936,505 | $66,554,927 |
| Senior housing | 38,770,696 | 36,192,294 |
| Education and community services | 1,994,883 | 1,556,711 |
| General and administrative | 26,750,607 | 27,472,736 |
| | $134,452,691 | $131,776,668 |

## 17. Commitments and Contingencies

### Internal Revenue Service Examination

In July 2009, the IRS notified Franciscan Ministries that it will examine Franciscan Ministries' 2007 tax return. The examination was later expanded to include the 2008 tax return and certain employee benefit issues. In January 2012, the IRS notified Franciscan Ministries that the tax returns were accepted; however, certain employee benefits issues are still under examination. Management has no estimate of potential liability, if any, at this time.

### Other Contingencies

Franciscan Ministries is a defendant in a class action lawsuit filed in conjunction with the termination of the St. Anthony Medical Center, Inc. Retirement Plan (the "Plan"). Franciscan Ministries believes that the suit is without merit and intends to vigorously defend its position.

Franciscan Ministries is a defendant in various other legal actions that have arisen in the normal course of business. Franciscan Ministries believes that the eventual resolution of these claims will not have a material effect on Franciscan Ministries' financial position or operations.

On August 14, 2015, Franciscan Communities entered into a construction contract to renovate the nursing home at Franciscan Village. The total contract price is $5,850,976, with the balance to finish, including retainage of $1,547,954. The renovation period is estimated to be completed in October 2016.

## 17. Commitments and Contingencies (continued)

On September 9, 2015, Franciscan Communities entered into a construction contract to build a club house on the campus of Marian Village. The total contract price is $438,598, with the balance to finish of $146,185. The construction period is estimated to be completed in October 2016.

On June 7, 2016, Franciscan Communities entered into a construction contract to renovate the lobby at St. Anthony Nursing Home. The total contract price is $567,221 and the renovation period is estimated to be four months.

## 18. Guarantees

Franciscan Ministries has agreed to provide an Operating Deficit Guarantee and Tax Credit Guarantee for Crete Senior Housing, LLC, which provides affordable senior housing in Crete, Illinois, on land owned by Franciscan Ministries. The Operating Deficit Guarantee is for a period of three years commencing with stabilization, which has not been met, limited to an amount equal to six months of operating expenses. The Operating Deficit Guarantee will be in the form of an operating loan bearing interest at 4 percent payable upon available cash flow. The Tax Credit Guarantee obligates Franciscan Ministries to reimburse the investor for losses (including interest and penalties) resulting from the recapture of low-income housing tax credits due to the project being operated in a manner inconsistent with the rent and affordability restrictions imposed by Section 42 of the Code. Tax credits will be guaranteed for five years from the issuance of 8609 tax certification. This guarantee would not become operative provided the residents occupying the building are within established income guidelines. The maximum aggregate amount that Franciscan Ministries shall be required to pay under the Operating Deficit Guarantee and the Tax Credit Guarantee is $512,740.

Franciscan Ministries has agreed to provide a Tax Credit Guarantee for Louisville Senior Housing, LLC, which provides affordable senior housing in Louisville, Kentucky. The Tax Credit Guarantee obligates Franciscan Ministries to reimburse the investor for losses (including interest and penalties) resulting from the recapture of low-income housing tax credits due to the project being operated in a manner inconsistent with the rent and affordability restrictions imposed by Section 42 of the Code. Tax credits will be guaranteed for five years from the issuance of 8609 tax certification. This guarantee would not become operative provided the residents occupying the building are within established income guidelines. The maximum aggregate amount that Franciscan Ministries shall be required to pay under the Operating Deficit Guarantee and the Tax Credit Guarantee is $823,850.

## 18. Guarantees (continued)

Franciscan Ministries has agreed to guarantee for Crete Senior Housing Phase II, LLC, which provides affordable senior housing in Crete, Illinois, on land owned by Franciscan Ministries, the payment of the recapture amount pursuant to the Section 1602 Grant documents and the payment of the repayment pursuant to the Home Program documents. The recapture amount under the Section 1602 Grant is eliminated over a 15-year compliance period. As of June 30, 2016 and 2015, the maximum amount due under the guarantee approximates $3,452,000 and $3,609,000, respectively, and is reported as Section 1602 Deferred Grant Revenue under noncurrent liabilities. This guarantee is not anticipated to be used as long as the residents occupying the building are within established income guidelines.

## 19. Self-Insurance Risks

Effective July 1, 2013, Franciscan Ministries is insured for workers' compensation through a fully funded insurance policy with normal statutory limit coverages in Indiana. Franciscan Ministries, prior to July 1, 2013, was self insured for workers' compensation losses up to a maximum limit of $300,000 per occurrence in Indiana. Franciscan Ministries is self insured for workers' compensation in Illinois and Kentucky up to a maximum limit of $450,000 per occurrence. Losses over these limits are covered by a supplemental catastrophic policy up to specified limits with an independent insurer. Estimated accruals for workers' compensation, which include estimates of the ultimate costs for both reported claims and claims incurred but not yet reported, were $1,549,904 and $1,445,068, undiscounted, as of June 30, 2016 and 2015, respectively.

Franciscan Ministries provides employee health insurance to its employees through a self-insured program. The self-insured program, implemented July 1, 2009, includes a specific stop-loss deductible of $200,000 per plan participant and an aggregate stop-loss policy with a maximum benefit of $1,000,000. Franciscan Ministries reported insurance claim liabilities of $807,000 and $650,000 as of June 30, 2016 and 2015, respectively, included in accounts payable and employee benefits, and an aggregate stop-loss receivable of $53,829 as of June 30, 2016 and 2015, respectively, which is included in prepaid expenses and other.

## 20. Community Commitment

The mission, values, and philosophy of Franciscan Ministries are reflected in the programs in place to provide care to the underprivileged population. Franciscan Ministries makes a major commitment to the community and residents in need by providing charity care to residents through the Gift of Care Program, sustaining significant amounts of unreimbursed costs by participation in the Medicaid program, and allocating significant resources to meet a number of community benefit needs identified.

The cost of providing charity care is calculated based upon the total cost-to-charge ratio based upon service line and payor class. The cost of the charity care amounted to $412,000 and $427,000 for the years ended June 30, 2016 and 2015, respectively.

## 20. Community Commitment (continued)

Unreimbursed costs represent the excess of resident care costs over Medicaid reimbursements. The amount of unreimbursed costs over Medicaid reimbursement is calculated based on allocated costs per resident day. Unreimbursed costs amounted to $4,354,000 and $5,145,000 for the years ended June 30, 2016 and 2015, respectively.

Franciscan Ministries addresses the spiritual needs of the community and those served through pastoral care services, including, but not limited to, chapel services. The costs of these pastoral care services amounted to $1,198,000 and $1,311,000 for the years ended June 30, 2016 and 2015, respectively.

## 21. Subsequent Events

Franciscan Ministries evaluated events and transactions occurring subsequent to June 30, 2016 through November 8, 2016, the date of issuance of the consolidated financial statements. During this period, there were certain subsequent events requiring disclosure, which are described below.

On July 11, 2016, Franciscan Communities entered into a construction contract to renovate the second floor of the nursing home at The Village at Victory Lakes. The total contract price is $839,568 and the renovation period is estimated to be five months.

# CONSOLIDATED FINANCIAL STATEMENTS

Franciscan Sisters of Chicago Service Corporation
and Subsidiaries
(d/b/a Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago)

Years Ended June 30, 2017 and 2016

With Reports of Independent Auditors

ADDENDUM 3

**Franciscan Sisters of Chicago Service Corporation and Subsidiaries**

**Consolidated Financial Statements and Details of Consolidation**

**Years Ended June 30, 2017 and 2016**

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# Independent Auditor's Report

To the Board of Directors
Franciscan Sisters of Chicago
Service Corporation and Subsidiaries

We have audited the accompanying consolidated financial statements of Franciscan Sisters of Chicago Service Corporation and Subsidiaries (d/b/a Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago) (Franciscan Ministries), which comprise the consolidated balance sheets as of June 30, 2017 and 2016 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 Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these 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.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these 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 audits 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 the auditor's 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, the auditor considers internal control relevant to the entity'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 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 consolidated financial statements.

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

***Emphasis of Matter***

As explained in Note 22 to the consolidated financial statements, effective July 1, 2016, Franciscan Ministries adopted new accounting guidance that changed the presentation of deferred bond issuance costs. Our opinion is not modified with respect to this matter.

Praxity
MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

To the Board of Directors
Franciscan Sisters of Chicago
Service Corporation and Subsidiaries

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Franciscan Sisters of Chicago Service Corporation and Subsidiaries (d/b/a Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago) as of June 30, 2017 and 2016 and the results of their operations and changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

November 15, 2017

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Balance Sheets

| | June 30 | |
|---|---|---|
| | 2017 | 2016 |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ **20,855,540** | $ 18,192,485 |
| Assets limited as to use - externally designated under debt agreements | **618,049** | 1,093,592 |
| Accounts receivable, less allowances for uncollectible accounts of $1,399,205 and $1,604,250 at June 30, 2017 and 2016, respectively | **6,447,716** | 6,612,490 |
| Due from third-party payors | **102,221** | 181,675 |
| Prepaid expenses and other | **4,526,002** | 4,767,170 |
| Total current assets | **32,549,528** | 30,847,412 |
| Assets limited as to use, net of amounts required to meet current obligations: | | |
| Internally designated for capital improvements | **104,985,972** | 98,405,224 |
| Externally designated under debt agreements and letters of credit | **21,490,806** | 14,978,384 |
| | **126,476,778** | 113,383,608 |
| Long-term investments | **1,422,808** | 1,102,994 |
| Other long-term assets | **6,723,318** | 7,465,149 |
| Property and equipment, net | **162,987,085** | 163,882,732 |
| Total assets | $ **330,159,517** | $ 316,681,895 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Balance Sheets (continued)

| | June 30 | |
|---|---|---|
| | 2017 | 2016 |
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 11,311,673 | $ 17,157,688 |
| Accrued salaries and employee benefits | 5,888,810 | 7,170,225 |
| Due to affiliates | 358,065 | 324,217 |
| Due to third-party payors | 962,171 | 966,243 |
| Current maturities of long-term debt | 2,582,117 | 3,022,918 |
| Current maturities of note payable to affiliate | 238,116 | 229,214 |
| Refundable resident deposits and entrance fees | 4,642,454 | 5,122,347 |
| Total current liabilities | 25,983,406 | 33,992,852 |
| Noncurrent liabilities: | | |
| Long-term debt, less current maturities | 182,826,583 | 170,249,655 |
| Note payable to affiliate, less current maturities | 4,520,834 | 4,757,724 |
| Section 1602 deferred grant revenue | 3,295,366 | 3,452,289 |
| Refundable resident deposits and refundable and nonrefundable entrance fees | 73,264,337 | 72,508,555 |
| Asset retirement obligations and other | 2,159,442 | 1,827,624 |
| Total noncurrent liabilities | 266,066,562 | 252,795,847 |
| Total liabilities | 292,049,968 | 286,788,699 |
| Net assets: | | |
| Noncontrolling interests in subsidiaries | 2,384,558 | 2,743,564 |
| Net assets: | | |
| Unrestricted | 26,336,908 | 18,653,294 |
| Temporarily restricted | 8,657,874 | 7,766,129 |
| Permanently restricted | 730,209 | 730,209 |
| | 35,724,991 | 27,149,632 |
| Total net assets | 38,109,549 | 29,893,196 |
| Total liabilities and net assets | $ 330,159,517 | $ 316,681,895 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

## Consolidated Statements of Operations and Changes in Net Assets

| | Years Ended June 30 | |
|---|---|---|
| | **2017** | **2016** |
| **Unrestricted revenues, gains, and other support** | | |
| Net resident service revenue, including amortization of entrance fees of $1,720,579 in 2017 and $1,948,079 in 2016 | **$ 118,588,512** | $ 116,982,939 |
| Contracted labor revenue | **9,873,066** | 9,786,465 |
| Lease revenue | **1,331,973** | 1,264,485 |
| Management services fee revenue | **1,549,208** | 624,262 |
| Other operating revenue | **4,648,356** | 4,816,372 |
| Total unrestricted revenues, gains, and other support | **135,991,115** | 133,474,523 |
| **Expenses** | | |
| Salaries and wages | **59,710,598** | 58,493,548 |
| Employee benefits | **13,288,398** | 12,711,476 |
| Agency | **370,205** | 49,630 |
| Purchased services - resident | **6,699,637** | 6,986,911 |
| Purchased services - general | **10,233,000** | 10,736,292 |
| Drugs, food, supplies, and other | **10,449,510** | 10,585,961 |
| Administrative, utilities, and insurance | **13,652,152** | 12,905,330 |
| Provision for uncollectible accounts | **840,825** | 750,372 |
| Interest | **9,188,769** | 9,040,036 |
| Depreciation and amortization | **12,326,514** | 12,193,135 |
| Total operating expenses | **136,759,608** | 134,452,691 |
| Loss from operations | **(768,493)** | (978,168) |
| **Nonoperating** | | |
| Realized investment income | **5,437,979** | 3,857,815 |
| Net change in unrealized gains (losses) on investments - trading portfolio | **3,966,049** | (1,175,157) |
| Gain on sale of Symbria shares - see footnote 6 | **–** | 8,387,700 |
| Gain on sale of joint venture | **415,757** | – |
| Loss on debt extinguishment | **(1,362,445)** | – |
| Contribution revenue and other | **294,996** | 155,609 |
| Total nonoperating | **8,752,336** | 11,225,967 |
| Revenues in excess of expenses | **7,983,843** | 10,247,799 |
| Revenues in excess of expenses allocated to noncontrolling interests (net loss of noncontrolling interest in sub) | **(359,005)** | (362,575) |
| Revenues in excess of expenses allocated to Franciscan Sisters of Chicago Service Corporation | **8,342,848** | 10,610,374 |

*See accompanying notes to consolidated financial statements.*

## Franciscan Sisters of Chicago Service Corporation and Subsidiaries

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

| | Years Ended June 30 | |
|---|---|---|
| | 2017 | 2016 |
| **Other changes in unrestricted net assets** | | |
| Net change in unrealized losses on investments – other-than-trading portfolio | $ (180,286) | $ (175,664) |
| Net assets released from restrictions used for capital purposes | 21,051 | 8,840 |
| Transfers to affiliates | (500,000) | (500,000) |
| Total other changes in unrestricted net assets | (659,235) | (666,824) |
| Increase in unrestricted net assets | 7,683,615 | 9,943,550 |
| **Temporarily restricted net assets** | | |
| Contributions for specific programs and asset purchases | 1,626,847 | 655,878 |
| Net assets released from restrictions | (735,102) | (495,749) |
| Increase in temporarily restricted net assets | 891,745 | 160,129 |
| **Permanently restricted net assets** | | |
| Investment income | 9,033 | 2,304 |
| Transfers to unrestricted net assets | (9,033) | (2,304) |
| Change in permanently restricted net assets | – | – |
| Increase in net assets | 8,575,360 | 10,103,679 |
| **Changes in net assets of noncontrolling interest** | | |
| Net loss of noncontrolling interests in subsidiaries | (359,007) | (362,575) |
| Decrease in net assets of noncontrolling interests | (359,007) | (362,575) |
| Net increase in total net assets | 8,216,353 | 9,741,104 |
| Net assets at beginning of year | 29,893,196 | 20,152,092 |
| Net assets at end of year | $ 38,109,549 | $ 29,893,196 |

*See accompanying notes to consolidated financial statements.*

**Franciscan Sisters of Chicago Service Corporation and Subsidiaries**

**Consolidated Statements of Cash Flows**

| | Years Ended June 30 | |
|---|---|---|
| | 2017 | 2016 |
| **Operating activities** | | |
| Increase in net assets | $ 8,216,353 | $ 9,741,104 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 12,326,514 | 12,193,135 |
| Amortization of entrance fees | (1,720,579) | (1,948,079) |
| Amortizaiton of deferred bond issuance costs, bond discounts, and bond premiums | 183,718 | 186,351 |
| Amortization of Section 1602 grants | (156,922) | (156,922) |
| Loss on debt extinguishment | 1,362,445 | – |
| (Gain) loss on disposal of assets | (1,885) | 1,435 |
| Provision for uncollectible accounts | 840,825 | 750,372 |
| Restricted contributions, net of assets released from restrictions used for operations | (891,745) | (160,129) |
| Reduction in contributed land lease rights | 156,616 | 156,616 |
| Net change in unrealized (gains) losses on investments | (3,785,763) | 1,350,821 |
| Gain on sale of shares of Symbria, Inc. | – | (8,387,700) |
| Gain on sale of joint venture | (415,757) | – |
| Transfer to affiliate | 500,000 | 500,000 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and due to/from third-party payors | (600,669) | (587,337) |
| Accounts payable, accrued salaries, prepaid expenses, deferred marketing costs, and other | (7,090,534) | 544,374 |
| Nonrefundable entrance fees | 1,765,853 | 1,749,863 |
| Due to (from) affiliate | 33,848 | (75,516) |
| Net cash provided by operating activities | 10,722,318 | 15,858,388 |
| **Investing activities** | | |
| Purchases of property and equipment, net, and other | (11,543,972) | (13,395,055) |
| Proceeds from sale of assets | 1,885 | – |
| Proceeds from sale of shares of Symbria, Inc. | – | 3,162,570 |
| Proceeds from sale of joint venture | 1,744,943 | – |
| Purchase of assets limited as to use and other investments - trading portfolio, net | (10,002,345) | (6,359,497) |
| Sales of assets limited as to use and other investments - other-than-trading portfolio, net | 835,599 | 732,652 |
| Net cash used in investing activities | (18,963,890) | (15,859,330) |
| **Financing activities** | | |
| Scheduled principal payments of long-term debt | (3,121,190) | (2,181,258) |
| Payments on note payable to affiliate | (227,988) | (218,153) |
| Proceeds from issuance of long-term debt | 90,734,794 | – |
| Early payment of long-term debt | (75,712,208) | – |
| Payment of bond issuance costs | (1,311,433) | – |
| Transfers to affiliates | (500,000) | (500,000) |
| Proceeds from refundable resident deposits | 11,888,894 | 11,220,599 |
| Refunds of resident deposits | (11,737,987) | (10,424,099) |
| Proceeds from restricted contributions and gains on investments, net of assets released from restrictions | 891,745 | 160,129 |
| Net cash provided by (used in) financing activities | 10,904,627 | (1,942,782) |
| Increase (decrease) in cash and cash equivalents | 2,663,055 | (1,943,723) |
| Cash and cash equivalents at beginning of year | 18,192,485 | 20,136,208 |
| Cash and cash equivalents at end of year | $ 20,855,540 | $ 18,192,485 |

*See accompanying notes to consolidated financial statements.*



ADDENDUM 3

## 1. Organization and Summary of Significant Accounting Policies

### Organization and Basis of Presentation

Franciscan Sisters of Chicago Service Corporation and Subsidiaries, which is sponsored by the Franciscan Sisters of Chicago (the "Sisters"), is an Illinois not-for-profit corporation, which coordinates all of the Sisters' sponsored facilities and assists the Sisters in extending their charitable mission in health care and educational foundations in the Chicago metropolitan area, northern Indiana, Ohio, and Kentucky. Effective February 2015, Franciscan Sisters of Chicago Service Corporation began doing business as Franciscan Ministries Sponsored by the Franciscan Sisters of Chicago (Franciscan Ministries).

The consolidated financial statements include the accounts and transactions of Franciscan Ministries (Service Corporation), Franciscan Communities, Inc. Obligated Group (Obligated Group), SAMC, Inc. (Medical Center), St. Joseph Senior Housing (St. Joseph Housing), Franciscan Community Services, Inc. (Community Services), Franciscan Community Benefit Services, Inc. (CBS), Franciscan Advisory Services, Inc. (FAS), and Franciscan Communities, Inc. II (FC II). The operating divisions of CBS include Madonna Foundation and St. Jude House, Inc. The operating divisions of St. Joseph Housing include Crete Senior Housing I, LLC, Crete Senior Housing Phase II, LLC, and Louisville Senior Housing, LLC. The portion of Crete Senior Housing Phase II, LLC and Louisville Senior Housing, LLC not owned by St. Joseph Housing is reported as non-controlling interest in the consolidated financial statements.

The members of the Obligated Group include Franciscan Communities, Inc. (Franciscan Communities) and University Place, Inc. Franciscan Communities includes the following operating divisions: Addolorata Villa, Franciscan Village, Marian Village, Mount Alverna Village (Mount Alverna), St. Anthony Home (St. Anthony), St. Anthony Management Services (Management Services), St. Joseph Village of Chicago (St. Joseph), and The Village at Victory Lakes (Victory Lakes).

Franciscan Ministries, the Obligated Group, Community Services, Medical Center, CBS, and FC II are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the "Code") and are not private foundations within the meaning of Section 509(a) of the Code. St. Joseph Housing is a tax-exempt organization under Section 501(c)(4) of the Code and is not a private foundation within the meaning of Section 509(a) of the Code.

A for-profit subsidiary of Franciscan Ministries, FAS was incorporated on June 16, 2011 with the purpose of managing certain ministries of the Sisters that did not meet the definition of the exempt purpose of Franciscan Ministries.

FC II is an Illinois not-for-profit, tax-exempt corporation established during the year ended June 30, 2017 for the purpose of building and operating a memory care assisted living facility in Parma, Ohio.

All significant intercompany transactions have been eliminated in consolidation.

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

### 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 at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time that the estimates are made, actual results could differ.

### Cash Equivalents

It is Franciscan Ministries' policy to reflect all investments that are not limited as to use and that have a maturity of three months or less at the time of acquisition as cash equivalents.

### Cash Concentration

Franciscan Ministries has cash on deposit with financial institutions, which at times may be in excess of federally insured limits.

### Assets Limited as to Use and Long-Term Investments

Assets limited as to use consist of investments set aside by the Board of Directors for future capital improvements, over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes. In addition, assets limited as to use include investments held by trustees under debt agreements and amounts as collateral for workers' compensation letters of credit.

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. Investment income is included in revenues in excess of expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses in the value of other-than-trading portfolio investments are recognized as changes in unrestricted net assets, while the unrealized gains and losses in the value of the trading portfolio investments are recognized as a non-operating gain or loss.

Effective November 1, 2002, Franciscan Ministries established an investment pool. Investments of Franciscan Ministries held in the investment pool amounted to $102,846,187 and $95,249,555 at June 30, 2017 and 2016, respectively, and are included in assets limited as to use, internally designated for capital improvements on the accompanying consolidated balance sheets.

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

Franciscan Ministries' investments are exposed to various risks, such as interest rate, market, and credit risk. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in risks in the near term could materially affect the amounts reported in the consolidated balance sheets.

### Accounts Receivable

Accounts receivable for residents, insurance companies, and governmental agencies are based on net charges. Franciscan Ministries evaluates the collectability of its accounts receivable based on the length of time the receivable is outstanding, payor class, and the anticipated future uncollectible amounts based on historical experience. Accounts receivable are charged to the allowance for uncollectible accounts when they are deemed uncollectible. Franciscan Ministries does not require collateral.

### Deferred Bond Issuance Costs

Expenses incurred in connection with the issuance of bonds are deferred and amortized over the terms of the related bonds. These costs are recorded as a direct reduction in the recorded balance of the related outstanding long-term debt. During the year ended June 30, 2017, $1,311,433 of deferred bond issuance costs were paid related to the Series 2017 bonds described in Note 8. In addition, $1,120,575 of deferred bond issuance costs were written off related to bonds refunded with the Series 2017 bonds. Deferred bond issuance costs are stated net of accumulated amortization of $765,962 and $1,090,796 at June 30, 2017 and 2016, respectively. See Note 22 related to change in accounting principle for deferred bond issuance costs.

### Property and Equipment

Property and equipment are stated on the basis of cost or, if donated to Franciscan Ministries, at fair value on the date of acquisition. Provisions for depreciation are computed using the straight-line method over the estimated useful lives of the assets ranging from three to 40 years.

Costs directly related to the acquisition, development, and improvement of real estate are capitalized, including interest and other costs incurred during the construction period. Costs incurred for significant repairs and maintenance that extend the usable life of the asset or have a determinable useful life are capitalized. Ordinary repairs and maintenance are expensed as incurred.

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

### Land Lease Rights

Franciscan Ministries has rights to lease from a related party 30.8 acres of land at Franciscan Village and 80.0 acres of land at Marian Village through June 30, 2050. Each of these leases call for annual payments of $1 throughout the term of the lease agreements. Franciscan Ministries has determined that the required lease payments are less than fair value and therefore has recorded the estimated fair value of future lease payments as land lease rights in property and equipment on the consolidated balance sheet with a corresponding contribution of land lease rights as temporarily restricted net assets. The amounts totaled $5,168,308 and $5,324,924 at June 30, 2017 and 2016, respectively. The land lease rights and temporarily restricted net assets are amortized as lease expense and an unrestricted contribution (net assets released from restriction), respectively, over the terms of the leases.

### Asset Retirement Obligations

Asset retirement obligations represent an obligation to dispose of assets that are legally required to be removed at a future date. Such obligations are recorded at the net present value using a risk-free interest rate and inflationary rate. As of June 30, 2017 and 2016, the asset retirement obligation for Franciscan Ministries was $522,298 and $507,085 respectively.

### Refundable Resident Deposits and Entrance Fees

Franciscan Ministries offers various independent living residency agreement options, including rental agreements and entrance fees with variable contract options, which include 90 percent refundable, 50 percent refundable, and fully amortizable programs.

Refundable resident deposits represent amounts received from prospective independent living residents, placing them on a priority list and making them eligible, once qualified, to receive certain resident benefits upon occupancy. A deposit of 10 percent of the entrance fee for the unit selected under the residency agreement makes the residents eligible to receive certain other benefits.

Upon a residents' occupancy, an entrance fee is reported as refundable to the extent the entrance fee is refundable to the resident according to the residency agreement. Nonrefundable entrance fees are reported as nonrefundable entrance fees. Nonrefundable entrance fees are amortized into revenue using the straight-line method based on the estimated life of the resident or contract term, if shorter. Franciscan Ministries may require entrance fees from assisted living residents. The entrance fees are refundable, in varying amounts, to the residents upon termination of the residency agreements. Total entrance fee amortization reported as net resident service revenue for the years ended June 30, 2017 and 2016 totaled $1,720,579 and $1,948,079, respectively.

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

Franciscan Ministries offers various entrance fee plans to prospective residents. Based upon the type of plan, Franciscan Ministries may have a financial obligation to provide future healthcare benefits to the residents. Management calculated the future service obligation, and concluded that there is no liability as of either June 30, 2017 or 2016.

### Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets include assets whose use have been limited by donors to a specific time period or purpose and contributed land lease rights. Permanently restricted net assets have been restricted by donors to be maintained by Franciscan Ministries and its related companies in perpetuity. Assets released from restrictions that are used for capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to unrestricted net assets. Assets released from restrictions that are used for operating purposes are reported in the consolidated statements of operations and changes in net assets as other operating revenue. Earnings on restricted net assets are recorded as temporarily restricted net assets until amounts are expended in accordance with donors' specifications.

### Contributions

Contributions are reported at fair value at the date of the contribution. Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost.

### Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. The gifts are reported as either temporarily or permanently restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets in the consolidated statements of operations and changes in net assets as net assets.

### Community Commitment

Franciscan Ministries provides care to residents who meet certain criteria without charge or at amounts less than established rates. Services to residents are classified as charity care in accordance with established criteria. Charity care represents services rendered for which partial payment is less than cost or no payment is expected and, as such, is not included in the net resident service revenue in the consolidated statements of operations and changes in net assets.

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

### Net Resident Service Revenue

Franciscan Ministries has agreements with third-party payors that provide for payments to Franciscan Ministries at amounts different from its established rates. Payment arrangements include prospectively determined rates, discounted charges, and per-diem payments. Net resident service revenue is reported at the estimated net realizable amounts from residents, third-party payors, and others for services rendered.

### Impairment of Long-Lived Assets

Franciscan Ministries considers whether indicators of impairment are present and performs the necessary tests in accordance with generally accepted accounting principles to determine if the carrying value of the asset is impaired. Impairment is recognized when estimated undiscounted operating income before depreciation and amortization is less than the carrying value of the property. To the extent that impairment has occurred, the excess of carrying value of the property over its estimated fair value is charged to operations. Impairment write-downs, if any, are reflected in loss from continuing operations. There was no impairment for the years ended June 30, 2017 and 2016.

### Revenues in Excess of Expenses

The consolidated statements of operations and changes in net assets include revenues in excess of expenses. Changes in unrestricted net assets, which are excluded from revenues in excess of expenses, include changes in the unrealized gains and losses on other-than-trading portfolio investments, transfers to affiliates, and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purpose of acquiring such assets).

### Federal Income Tax

Franciscan Ministries has analyzed the tax positions taken in its filings with the Internal Revenue Service (IRS) and state jurisdictions where it operates. Franciscan Ministries believes that its income tax filing positions will be sustained upon examination and does not anticipate any adjustments that would result in a material adverse effect on Franciscan Ministries' financial condition, results of operations, or cash flows. Accordingly, Franciscan Ministries has not recorded any reserves or related accruals for interest and penalties for uncertain income tax positions at June 30, 2017 and 2016.

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

### Accounting Standards Update

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), which will supersede the current revenue recognition requirements in Topic 605, *Revenue Recognition*. The ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The new guidance will be effective for Franciscan Ministries' year ending June 30, 2019. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods. Franciscan Ministries has not yet determined which application method they will use and is in the process of evaluating the impact of the new standard on its financial statements.

In February 2016, the Financial Accounting Standards Board issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statements of operations and changes in net assets. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for Franciscan Ministries' year ending June 30, 2020 and will be applied using a modified retrospective transition method to the beginning of the earliest period presented. Franciscan Ministries is currently evaluating the impact this standard will have on the financial statements.

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities in August 2016. ASU No. 2016-14 requires significant changes to the financial reporting model of organizations who follow FASB not-for-profit rules, including changing from three classes of net assets to two classes, net assets with donor restrictions and net assets without donor restrictions. The ASU will also require changes in the way certain information is aggregated and reported by Franciscan Ministries, including required disclosures about the liquidity and availability of resources. The new standard is effective for Franciscan Ministries' year ending June 30, 2019 and thereafter and must be applied on a retrospective basis. Franciscan Ministries expects that this will have a significant effect on the classification and presentation of net assets but does not expect this to impact the value of net assets.

## 2. Contractual Arrangements with Third-Party Payors

Franciscan Ministries provides care to certain residents under payment arrangements with Medicare, Medicaid, and various health maintenance and preferred provider organizations. Services provided under these arrangements are paid at predetermined rates and/or per-diem rates, as defined. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, and as a result, there is a possibility that recorded estimates may change.

Amounts received under Medicare and Medicaid payment arrangements accounted for 31 percent of Franciscan Ministries' net resident service revenue in both 2017 and 2016. Medicare and Medicaid accounts receivable accounted for 51 percent and 56 percent of Franciscan Ministries' net accounts receivable at June 30, 2017 and 2016, respectively.

Provision has been made in the consolidated financial statements for estimated contractual adjustments, recorded in net resident revenue in the consolidated statements of operations and changes in net assets, representing the difference between Franciscan Ministries' standard charges for services and the estimated payments to be received from the third-party payors.

## 3. Entrance Fees and Deposits

Franciscan Ministries may require security deposits of various amounts from private pay residents at the time of admission for nursing care. The security deposits are fully refundable to the residents upon discharge from a community. The security deposits are included in current liabilities and reported as refundable resident deposits and entrance fees. The security deposits amounted to $781,943 and $640,302 at June 30, 2017 and 2016, respectively.

Franciscan Ministries requires entrance fees from assisted living residents. The refundable portion of the entrance fees varies by community and is refundable to the resident upon discharge from the community. The refundable portion of the entrance fees is included in current liabilities and reported as refundable resident deposits and entrance fees. The nonrefundable portion of the entrance fee is included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $720,922 and $782,119 at June 30, 2017 and 2016, respectively. The nonrefundable portion of these entrance fees amounted to $202,090 and $172,431 at June 30, 2017 and 2016, respectively.

### 3. Entrance Fees and Deposits (continued)

Prospective independent living residents are subject to reservation deposits up to a maximum of 10 percent of the entrance fee for the unit selected under the residency agreements, making the residents eligible to receive certain other benefits. Upon occupancy, the resident is charged the remaining 90 percent of the entrance fee. The reservation deposits are fully refundable if the contract is terminated prior to occupancy, and they are included in current liabilities and reported as refundable resident deposits and entrance fees. Reservation deposits amounted to $181,634 and $255,223 at June 30, 2017 and 2016, respectively.

Franciscan Ministries requires entrance fees, in varying amounts, in certain independent living residency agreements. Under the terms of these residency agreements, the amount of the refundable portion varies and is refundable upon termination of the residency agreements. The refundable portion of the entrance fee is included in current liabilities and reported as refundable resident deposits and entrance fees. The nonrefundable portion is included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $2,957,955 and $3,444,703 at June 30, 2017 and 2016, respectively. The nonrefundable portion of these entrance fees amounted to $372,899 and $327,169 at June 30, 2017 and 2016, respectively.

Franciscan Ministries also requires entrance fees, in varying amounts, under other independent living residency agreements. Under the terms of these residency agreements, the amount of the refundable portion varies and is refundable upon termination, reoccupancy of the vacated unit, and leaving the community before amounts are required to be refunded. The refundable and nonrefundable portions of the entrance fees are included in noncurrent liabilities and reported as refundable resident deposits and nonrefundable entrance fees. The refundable portion of these entrance fees amounted to $67,301,345 and $66,456,578 at June 30, 2017 and 2016, respectively. The nonrefundable portion of these entrance fees amounted to $5,388,003 and $5,552,377 at June 30, 2017 and 2016, respectively.

### 4. Investments and Other Financial Instruments

Total investment return for the years ended June 30 is summarized as follows:

| | **2017** | **2016** |
|---|---|---|
| Dividend and interest income | **$ 2,751,973** | $ 2,551,305 |
| Realized gains | **3,240,173** | 1,835,527 |
| Investment fees | **(457,723)** | (414,485) |
| Unrealized gains (losses) | **3,785,763** | (1,350,821) |
| | **$ 9,320,186** | $ 2,621,526 |

## 4. Investments and Other Financial Instruments (Continued)

As reported on the Consolidated Statement of Operations and Changes in Net Assets:

| | 2017 | 2016 |
|---|---|---|
| Other operating revenue | **$ 96,444** | $ 114,532 |
| Nonoperating: | | |
| Net investment income | **5,437,979** | 3,857,815 |
| Net change in unrealized gains on investments - trading portfolio | **3,966,049** | (1,175,157) |
| Other changes in unrestricted net assets - | | |
| Net change in unrealized gains/losses on investments - other-than-trading portfolio | **(180,286)** | (175,664) |
| | **$ 9,320,186** | $ 2,621,526 |

## 5. Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement and Disclosures,* establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of input that may be used to measure fair value:

- Level 1: Quoted prices (unadjusted) for identical assets in active markets that the entity has the ability to access as of the measurement date. The fair values of debt and equity investments that are readily marketable are determined by obtaining quoted prices on nationally recognized securities exchanges.

- Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data

- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy.

## 5. Fair Value Measurements (Continued)

### Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below as of June 30, 2017:

| | Level 1 | Level 2 | Level 3 | Investments Valued at Net Asset Value | Total |
|---|---|---|---|---|---|
| Internally designated investments: | | | | | |
| Franciscan Ministries Investment Pool: | | | | | |
| Equities - domestic | $ 33,397,997 | $ - | $ - | $ 31,641,561 | $ 65,039,558 |
| Equities - international | 536,196 | - | - | - | 536,196 |
| Mutual fund - fixed income | 32,458,996 | 2,743 | - | - | 32,461,739 |
| Cash and cash equivalents | 4,808,694 | - | - | - | 4,808,694 |
| Total Franciscan Ministries Investment Pool | 71,201,883 | 2,743 | - | 31,641,561 | 102,846,187 |
| Fixed income | 2,139,785 | - | - | - | 2,139,785 |
| Total internally designated investments | 73,341,668 | 2,743 | - | 31,641,561 | 104,985,972 |
| Externally designated investments: | | | | | |
| Fixed income | - | 8,280,405 | - | - | 8,280,405 |
| Cash and cash equivalents | 13,828,450 | - | - | - | 13,828,450 |
| Total externally designated investments | 13,828,450 | 8,280,405 | - | - | 22,108,855 |
| Long-term investments: | | | | | |
| Pooled equity funds | 1,422,808 | - | - | - | 1,422,808 |
| | $ 88,592,926 | $ 8,283,148 | $ - | $ 31,641,561 | $ 128,517,635 |

Assets measured at fair value on a recurring basis are summarized below as of June 30, 2016:

| | Level 1 | Level 2 | Level 3 | Investments Valued at Net Asset Value | Total |
|---|---|---|---|---|---|
| Internally designated investments: | | | | | |
| Franciscan Ministries Investment Pool: | | | | | |
| Equities - domestic | $ 27,465,281 | $ - | $ - | $ 25,832,428 | $ 53,297,709 |
| Equities - international | 611,596 | - | - | - | 611,596 |
| Mutual fund - fixed income | 32,007,283 | 3,355 | - | - | 32,010,638 |
| Cash and cash equivalents | 9,329,612 | - | - | - | 9,329,612 |
| Total Franciscan Ministries Investment Pool | 69,413,772 | 3,355 | - | 25,832,428 | 95,249,555 |
| Fixed income | 3,155,669 | - | - | - | 3,155,669 |
| Total internally designated investments | 72,569,441 | 3,355 | - | 25,832,428 | 98,405,224 |
| Externally designated investments: | | | | | |
| Fixed income | - | 10,130,568 | - | - | 10,130,568 |
| Cash and cash equivalents | 5,941,408 | - | - | - | 5,941,408 |
| Total externally designated investments | 5,941,408 | 10,130,568 | - | - | 16,071,976 |
| Long-term investments: | | | | | |
| Pooled equity funds | 1,102,994 | - | - | - | 1,102,994 |
| | $ 79,613,843 | $ 10,133,923 | $ - | $ 25,832,428 | $ 115,580,194 |

**5. Fair Value Measurements (Continued)**

Fair value for Level 1 assets is based on quoted market prices. Level 2 investments are valued by pricing services utilized by Franciscan Ministries' investment managers in which quoted market prices for similar instruments in active markets are used to determine fair value.

As of June 30, 2017 and 2016, there are no liabilities measured at fair value on a recurring basis.

Franciscan Ministries' policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the actual date of the event of change in circumstances that caused the transfer. There were no transfers between levels at June 30, 2017 and 2016.

**Investments in Entities that Calculate Net Asset Value per Share**

Franciscan Ministries holds shares or interests in investment companies within the investment pool at year end whereby the fair value of the investment held is estimated based on net asset value per share (or its equivalent) of the investment companies.

At year end, the fair value, unfunded commitments, and redemption rules of these investments is as follows:

| Fund | 2017 Fair Value | 2016 Fair Value | Unfunded Commitments | Redemption Frequency | Redemption Notice Period |
|---|---|---|---|---|---|
| Boston Common International Catholic SRI Fund | $ 10,702,647 | $ 7,582,625 | $ - | No Restriction | 30 days |
| Martingale Investment Trust | 15,809,745 | 14,115,710 | - | No Restriction | 10 days |
| American Core Realty Fund, LP | 5,129,169 | 4,134,093 | - | Quarterly | 10 days |

The Boston Common International Catholic SRI Fund includes a diversified portfolio of non-U.S. stocks of high-quality companies with the objective of achieving long-term capital appreciation.

The Martingale Investment Trust *Series 1: U.S. Low Volatility LargeCap* + employs a low volatility equity strategy with the objective of earning equity market returns over the long term with lower volatility than the market index. The underlying investments consist of U.S. large cap equity securities, exchange traded funds, and cash equivalents.

The American Core Realty Fund, LP is an open-end real estate investment fund that invests directly and/or indirectly through joint ventures, partnerships, and other participations with others, including senior and subordinate debt investments, generally in stable, institutional quality office and retail, industrial, and multifamily residential properties that generally are substantially leased with minimal deferred maintenance or functional obsolescence.

## 6. Symbria, Inc.

In October 2015, Franciscan Ministries sold its shares of Symbria, Inc. to the Symbria, Inc. Employees Stock Ownership Trust. Prior to October 2016, Franciscan Ministries had accounted for the investment in Symbria using the cost method. As a result of the sale, the following consideration was received: $3,162,570 in cash, $6,337,130 in an interest-bearing unsecured note, and 64,103 unexercised warrant shares. The interest-bearing note is subject to certain clawback provisions. In the event Symbria fails to meet agreed-upon projected earnings on a cumulative basis for the period beginning on April 1, 2015 and ending on March 31, 2018, the ESOP purchase price in the aggregate shall be reduced by the amount of any shortfall in earnings multiplied by 8.5 (the "Clawback"). Franciscan Ministries has recorded a $1,000,000 valuation against the interest-bearing note for the maximum amount of the Clawback attributable based on the shares of Symbria, Inc. held at the sale date. Franciscan Ministries did not record any amounts related to the warrant shares as the strike price of the warrants is comparable to the current market value of shares of Symbria, Inc. Employees Stock Ownership Trust. The subordinated note receivable plus accrued interest totaling $5,658,113 and $5,450,801 at June 30, 2017 and 2016, respectively, is recorded in the consolidated balance sheets as other long-term assets.

## 7. Property and Equipment

Property and equipment are as follows at June 30:

| | 2017 | 2016 |
|---|---|---|
| Land and land improvements | **$42,402,683** | $41,950,006 |
| Land lease rights | **5,168,308** | 5,324,924 |
| Building and improvements | **262,917,338** | 251,913,194 |
| Furniture and moveable equipment | **37,302,716** | 35,131,562 |
| Construction in progress | **743,730** | 7,538,348 |
| | **348,534,775** | 341,858,034 |
| Less accumulated depreciation | **(185,547,690)** | (177,975,302) |
| | **$162,987,085** | $163,882,732 |
| | | |
| Depreciation expense | **$12,283,004** | $12,018,787 |

## 8. Long-Term Debt

Long-term debt consisted of the following at June 30:

| | 2017 | 2016 |
|---|---|---|
| Illinois Finance Authority Revenue Bonds: | | |
| Series 2004B, principal payable in varying annual installments from 2026 through 2034; interest rate 6.50% | - | $ 3,060,000 |
| Series 2007A, principal payable in varying annual installments from 2013 through 2037; interest rates ranging from 5.25% to 5.50% | - | 40,120,000 |
| Series 2013A, principal payable in varying annual installments from 2014 through 2047; interest rate ranging from 2.15% to 5.25% | **$ 93,955,000** | 95,830,000 |
| Series 2013B, principal payable in varying monthly installments from 2013 through 2043; interest rates vary monthly based on prevailing market conditions (2.28% at June 30, 2016) | - | 10,461,829 |
| Series 2017A, principal payable in varying annual installments from 2018 through 2047; interest rates ranging from 3.25% to 5.00% | **38,405,000** | - |
| The Huntington National Bank: | | |
| Series 2013C, principal payable in varying monthly installments from 2013 through 2043; interest rates vary monthly based on prevailing market conditions (3.01% June 30, 2016) | - | 15,261,689 |
| Series 2017B, principal payable in varying monthly installments from 2018 through 2047; interest rate 2.80% | **4,327,000** | - |
| Series 2017C, principal payable in varying annual installments from 2018 through 2047; interest rates vary monthly based on prevailing market conditions (1.86% at June 30, 2017) | **10,442,000** | - |
| Series 2017E, principal payable in varying monthly installments from 2018 through 2027; interest rates vary monthly based on prevailing market conditions (2.92% at June 30, 2017) | **15,231,000** | - |

| | 2017 | 2016 |
|---|---|---|
| The Wintrust Bank: | | |
| Series 2017D, principal payable in varying monthly installments from 2018 through 2047; interest rate 2.83% | **$ 20,935,800** | - |
| County of Cuyahoga, Ohio Healthcare Facilities Revenue Bonds | | |
| Series 2004C, principal payable in varying annual installments from 2028 through 2032; interest rate 6.25% | - | $ 5,255,000 |
| Series 2004D, principal payable in varying annual installments from 2033 through 2034; interest rate 6.50% | - | 2,745,000 |
| Illinois Housing Development Authority Mortgage Note, interest at 3.75%, principal due 2049; interest paid monthly | **2,296,570** | 2,330,521 |
| Illinois Housing Development Authority Mortgage Note, interest-only payments through 2017, principal due 2047; interest paid monthly; interest rate 1.0% | **1,108,352** | 1,111,000 |
| Illinois Housing Development Authority Mortgage Note, principal due 2047; interest rate 6.08% | **1,596,799** | 1,615,090 |
| | **188,297,521** | 177,790,129 |
| Less current maturities of long-term debt | **(2,582,117)** | (3,022,918) |
| Add (less) net bond premium (discount) | **37,737** | (1,659,210) |
| Less unamortized deferred bond issuance costs – net of accumulated amortization | **(2,926,558)** | (2,858,346) |
| | **$182,826,583** | $170,249,655 |

Annual maturities of long-term debt and sinking fund requirements as of June 30, 2017, for each of the next five years, are as follows:

| | |
|---|---|
| 2018 | $ 2,582,117 |
| 2019 | 3,542,398 |
| 2020 | 3,652,208 |
| 2021 | 3,773,956 |
| 2022 | 3,899,548 |
| Thereafter | 170,847,294 |

**8. Long-Term Debt (continued)**

Effective June 28, 2017, the Illinois Finance Authority (the "Authority"), on behalf of the Obligated Group, issued its Illinois Finance Authority Revenue Bonds, Series 2017A (Franciscan Communities, Inc. Obligated Group) (the "Series 2017A Bonds") in the aggregate principal amount of $38,405,000. The Series 2017A Bonds are subject to optional, mandatory, and extraordinary redemption, as described in the Official Statement related to the Series 2017A Bonds. The Series 2017A Bonds were issued pursuant to a Bond Trust Indenture, dated as of June 1, 2017, by and between the Authority and Amalgamated Bank of Chicago, as bond trustee ("Bond Trustee"). The proceeds of the Series 2017A Bonds were loaned by the Authority to Franciscan Communities ("FC") pursuant to a Loan Agreement, dated as of June 1, 2017, by and between FC and the Authority.

The Obligated Group applied the proceeds from the sale of the Series 2017A Bonds, together with other funds, to: (i) refund all of the outstanding Illinois Finance Authority Revenue Refunding Bonds, Series 2007A (Franciscan Communities, Inc.) (the "Series 2007A Bonds"); (ii) fund a debt service reserve fund for the benefit of the Series 2017A Bonds; and (iii) pay certain expenses incurred in connection with the issuance of the Series 2017A Bonds and the refunding of the Series 2007A Bonds.

The Series 2017A Bonds are limited obligations of the Authority and are secured in part by the Obligated Group's Series 2017A Master Note in the principal amount of $38,405,000 (the "Series 2017A Note"). The Series 2017A Note was issued pursuant to the Amended and Restated Master Trust Indenture dated as of June 1, 2017, as supplemented by Supplemental Master Trust Indenture No. 1, dated as of June 1, 2017 (as supplemented, the "Master Indenture"), by and among FC and University Place ("UP"), as the current Members of the Obligated Group, and Amalgamated Bank of Chicago, as successor master trustee.

As part of the overall plan of finance for the Obligated Group, the Authority also issued its Revenue Bonds, Series 2017B (Franciscan Communities, Inc. Obligated Group) (the "Series 2017B Bonds") in the aggregate principal amount of $4,327,000 for the benefit of the Obligated Group that were purchased directly by Huntington Public Capital Corporation (the "Series 2017B Bank Purchaser"), its Revenue Bonds, Series 2017C (Franciscan Communities, Inc. Obligated Group) (the "Series 2017C Bonds") in the aggregate principal amount of $10,442,000 for the benefit of the Obligated Group that were purchased directly by Huntington Public Capital Corporation (the "Series 2017C Bank Purchaser"), and its Revenue Bonds, Series 2017D (Franciscan Communities, Inc. Obligated Group) (the "Series 2017D Bonds") in the aggregate principal amount of $20,935,800 for the benefit of the Obligated Group that were purchased directly by Wintrust Bank (the "Series 2017D Bank Purchaser"). In addition, the Obligated Group entered into a term bank loan (the "Series 2017E Taxable Term Loan") with The Huntington National Bank in the principal amount of $15,231,000.

**8. Long-Term Debt (continued)**

The Series 2017B Bonds and Series 2017C Bonds mature on May 15, 2047, but are subject to mandatory purchase by the Obligated Group on June 30, 2027, if the terms of the Series 2017B Bonds and Series 2017C Bonds are not extended by mutual agreement of the Obligated Group and the Series 2017B Bank Purchaser and the Series 2017C Bank Purchaser, respectively. The Series 2017D Bonds mature on May 15, 2047, but are subject to mandatory purchase by the Obligated Group on June 28, 2027, if the terms of the Series 2017D Bonds are not extended by mutual agreement of the Obligated Group and the Series 2017D Bank Purchaser.

The maturity date of the Series 2017E Taxable Term Loan is June 30, 2027.

Additional Master Notes were issued to the Bank Purchasers to secure any payment obligations of the Obligated Group under the respective bank covenant agreements entered into with the respective Bank Purchasers (the "Bank Agreements") in addition to payment of principal of and interest on the Series 2017 Bank Bonds.

The proceeds of the Series 2017 Bank Bonds were loaned to the Obligated Group and used to: (i) finance, refinance, or reimburse the Obligated Group for the payment of certain costs of acquiring constructing, renovating, remodeling, and equipping certain projects for certain of the senior living facilities owned by the Obligated Group in the States of Illinois, Indiana, and Ohio; (ii) refund all of the (a) Illinois Finance Authority Revenue Bonds, Series 2004B (Franciscan Communities, Inc.) Extendable Rate Adjustable Securities$^{SM}$ (EXTRAS$^{SM}$) (the "Series 2004B Bonds"), (b) Illinois Finance Authority Revenue Bonds, Series 2013B (Franciscan Communities, Inc.) (the "Series 2013B Bonds" and together with the Series 2004B Bonds and the Series 2007A Bonds, the "Illinois Bonds"), (c) County of Cuyahoga, Ohio Health Care Facilities Revenue Bonds, Series 2004C (Franciscan Communities, Inc. – Mount Alverna Project) (the "Series 2004C Bonds"), and (d) County of Cuyahoga, Ohio Health Care Facilities Revenue Bonds, Series 2004D (Franciscan Communities, Inc. – Mount Alverna Project) Extendable Rate Adjustable Securities$^{SM}$ (EXTRAS$^{SM}$) (the "Series 2004D Bonds" and together with the Series 2004C Bonds, the "Ohio Bonds," and the Illinois Bonds and the Ohio Bonds are collectively referred to herein as the "Prior Bonds"); and (iii) pay certain expenses incurred in connection with the issuance of the Series 2017 Bank Bonds and the refunding of the Prior Bonds.

Proceeds of the Taxable Term Loan were used to refinance the taxable loan (the "Previous Taxable Term Loan") made to the Obligated Group under the Secured Credit Agreement dated as of March 1, 2013 between the Obligated Group and The Huntington National Bank.

The refinancing resulted in a loss on debt extinguishment of $1,362,445, which includes the write-off of unamortized deferred bond costs ($1,120,575), write-off of bond discounts ($149,624), and costs of bond refinancing ($92,246), and is included in the accompanying Statement of Operations and Changes in Net Assets for the fiscal year ended June 30, 2017.

## 8. Long-Term Debt (continued)

Crete Senior Housing, LLC has a secured first mortgage on the property with the Illinois Housing Development Authority in the amount of $1,596,799 and a second secured mortgage note in the amount of $1,108,352. Crete Senior Housing Phase II, LLC has a secured mortgage on the property with the Illinois Housing Development Authority in the amount of $2,296,570. Effective October 2, 2014, Louisville Senior Housing, LLC entered into a secured mortgage note with Franciscan Ministries in the amount of $1,799,733. The loan is amortized over 35 years with an interest rate of 4.00 percent and with a balloon payment due May 2030. Monthly principal and interest on the loan total $7,969. Franciscan Ministries has a secured first mortgage on the property. The proceeds of the loan were used to retire the U.S. Bank National Association mortgage note and pay certain costs of issuance of the loan.

Interest paid on long-term debt amounted to $8,676,064 and $8,916,816 in 2017 and 2016, respectively.

Interest was capitalized in the amount of $0 and $69,556 during the years ended June 30, 2017 and 2016, respectively.

The provisions of the Master Trust Indenture and the Taxable Term Loan as described above contain various restrictive covenants that limit the occurrence of additional debt and require certain measures of financial performance be satisfied as long as the bonds and Taxable Bank Loan are outstanding. Failure to maintain compliance could result in acceleration of payment for debt outstanding under the Master Trust Indenture and Taxable Term Loan. Management believes Franciscan Ministries is in compliance with such covenants at June 30, 2017 and 2016.

## 9. Grant Agreements

Crete Senior Housing Phase II, LLC (Crete II) has entered into a Section 1602 written agreement with the Illinois Housing Development Authority to obtain a grant under Sections 1065 and 1602 of the American Reinvestment and Recovery Act of 2009 (ARRA). Crete II was granted $4,315,360 under the Section 1602 program. The Section 1602 funds were used to assist in the financing of the acquisition and construction of the affordable housing building. These funds are subject to the Qualified Allocation Plan (QAP), the program requirements, and the terms and conditions of the written agreement, the mortgage note, the regulatory agreement, the provisions of Sections 1604 and 1602 of the ARRA, the guidelines, and any other rules, regulations, guidelines, and notices published by the U.S. Treasury or IRS from time to time with respect to the Section 1602 program that are applicable to the project. During the 15-year compliance period that ends on December 31, 2026, the project must meet occupant eligibility and unit gross rent, among other requirements. The amortization of deferred Section 1602 grant revenue totaled $156,922 for both years ended June 30, 2017 and 2016.

## 9. Grant Agreements (continued)

The Section 1602 grant funds are subject to recapture in the event of default by any noncompliance with the program requirements mentioned in the agreement, unless the noncompliance is cured within the stated time provided. For compliance purposes, this grant is also secured by a mortgage note that has a second lien on the property.

## 10. Leases

Addolorata Villa leases land under a ground lease agreement with the Servants of Mary, the original sponsor. The terms of the ground lease include an irrevocable option to purchase the land at a defined option price and an annual base rent of $1 through December 31, 2050.

## 11. State of Indiana Intergovernmental Transfer Program

Effective March 1, 2014, St. Anthony entered into a lease agreement with a county hospital, Hancock Regional Hospital (the "Hospital"), to lease the operations of the nursing facility (NF) and certain housing services (the "Convent") at St. Anthony to the Hospital (collectively, the operations of the NF and the Convent are referred to herein as the "Leased Property"). Concurrently, therewith, the Hospital entered into a management agreement between a newly-formed division of the Hospital, Hancock Regional Hospital (d/b/a St. Anthony Home - Crown Point) (SAH-CP), and a newly-formed division of Franciscan Communities, Inc. (d/b/a St. Anthony Management Services) (Management Services). Compensation to Management Services for management of the operations is provided as a percentage of net resident service revenue earned and certain fees. SAH-CP will reimburse St. Anthony for salaries, wages, and benefits of contracted labor provided to SAH-CP. Franciscan Communities entered into the lease agreement and the management agreement, as well as certain additional required agreements, in accordance with the requirements of participation in the State of Indiana's Intergovernmental Transfer (IGT) Program (the "Program"). In addition, St. Anthony was required to provide limited working capital to SAH-CP for the initial months of operation.

The Hospital, located in Greenfield, Indiana, is a county hospital, which is a primary requirement for participation for the Hospital and Franciscan Communities in the Program. Effective March 1, 2014 and thereafter, the operations of the Leased Property will be reported in the financial statements of the Hospital. Franciscan Communities, accordingly, reports the corresponding lease revenue and management services revenue under Management Services.

The operating lease related to the Leased Property was effective on March 1, 2014, is for an initial term of two (2) calendar years, and is renewable annually thereafter. Either party may terminate the lease, with or without cause, by providing a sixty (60) day written notice to the other party. The lease is expected to be renewed annually in the normal course of business. In accordance with guidelines established by the Centers for Medicare and Medicaid Services (CMS), the license for the NF was transferred to the Hospital as a result of the operating lease agreement.

## 11. State of Indiana Intergovernmental Transfer Program (continued)

Lease revenue amounted to $1,249,329 and $1,191,024 for the years ended June 30, 2017 and 2016, respectively. The lease amount is payable monthly to Franciscan Communities. In addition to the lease revenue, Franciscan Communities is entitled to certain additional payments from the Hospital in accordance with the various agreements. At June 30, 2017 and 2016, the amount due of $1,681,551 and $1,063,691, respectively, was due to Franciscan Communities from the Hospital for revenue earned under the various agreements, including management services revenue, lease payments, payroll expense, and working capital advances and is included in prepaid expenses and other.

If there is any possibility, as reasonably determined by the Hospital, that net patient revenues and working capital are not sufficient to pay all operating expense, interest expense, rent, and fees for SAH-CP, Management Services will immediately notify the Hospital and present a plan to the Hospital for addressing the unfavorable results. The plan could include a temporary reduction in management services revenue or other amounts paid to Management Services. Such a plan may also be established by the Hospital, if it reasonably determines that net patient revenues and working capital are not sufficient to fund the payments described in the various agreements.

## 12. Endowment Funds

The Sisters established endowment funds with St. Jude House, Inc. and Madonna Foundation by contributing $2,000,000 and $2,500,000, respectively. In 2013, the Sisters contributed an additional $500,000 to the endowment fund of St. Jude House, Inc. Per the agreement between the Sisters and St. Jude House, Inc. and Madonna Foundation, contributions to the endowment funds are to exist in perpetuity with the income and appreciation available to support the operational programs and services to benefit the clients of St. Jude House, Inc. and the scholars of Madonna Foundation. Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

| | Internally Restricted | | Permanently Restricted | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| Endowment funds: | | | | |
| Madonna Foundation | **$3,159,432** | $2,980,149 | **$ -** | $ - |
| St. Jude House, Inc. | **2,500,000** | 2,542,547 | **-** | - |
| Other | **-** | - | **730,209** | 730,209 |
| Total funds | **$5,659,432** | $5,522,696 | **$730,209** | $730,209 |

## 12. Endowment Funds (continued)

Changes in endowment net assets consisted of the following for the fiscal years ended June 30:

| | Internally Restricted | | Permanently Restricted | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| Endowment net assets, beginning of year | **$5,522,696** | $5,695,708 | **$730,209** | $730,209 |
| Investment return: | | | | |
| Investment income | **81,393** | 92,180 | **5,655** | 2,250 |
| Net income (realized and unrealized) | **432,756** | 578 | **3,378** | 54 |
| Total investment return | **514,149** | 92,758 | **9,033** | 2,304 |
| Net asset transfers to unrestricted net assets | **-** | - | **(9,033)** | (2,304) |
| Appropriation of endowment assets for expenditure | **(377,413)** | (265,770) | **-** | - |
| Endowment net assets, end of year | **$5,659,432** | $5,522,696 | **$730,209** | $730,209 |

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires Franciscan Ministries to retain as a fund or in perpetual duration. There were no deficiencies of donor-restricted endowment funds at June 30, 2017 and 2016.

## 13. Transactions with Affiliates

Notes payable to, and long-term arrangements with, affiliates consisted of the following at June 30:

| | **2017** | **2016** |
|---|---|---|
| Working capital loan agreement payable to the Franciscan Sisters of Chicago, Inc., due June 1, 2022, with monthly payments of principal and interest; interest rate 5.0% | **$ 4,758,950** | $ 4,986,938 |
| Less current maturities of note payable to affiliates | **238,116** | 229,214 |
| | **$ 4,520,834** | $ 4,757,724 |

On July 1, 2012, Franciscan Ministries entered into an unsecured promissory note payable with the Sisters in the amount of approximately $5,798,000. The term of the note was five years with a defined balloon payment subject to refinancing and bears interest at 5 percent. The note required monthly payments of approximately $39,000.

**13. Transactions with Affiliates (continued)**

On October 1, 2016, the Service Corporation entered into an unsecured promissory note payable, effective June 1, 2017, with the Sisters to replace the working capital loan agreement payable to the Sisters due July 1, 2022. The note, in the amount of $4,778,367, representing the working capital loan agreement balance at June 30, 2017, has a term of five years with a defined balloon payment subject to refinancing and bears interest at 4 percent. The note requires monthly payments of approximately $35,500.

On October 17, 2007, St. Joseph Housing entered into an unsecured working capital line-of-credit agreement with the Sisters. The agreement was effective on November 1, 2007 in an amount not to exceed $5,000,000. On October 31, 2012, the Sisters extended the maturity date of the capital line of credit agreement with St. Joseph Housing until November 1, 2017. There are no advances under the working capital line-of-credit at June 30, 2017 and 2016.

Effective July 21, 2014, Franciscan Ministries entered into a license agreement with the Sisters to make available and share certain space on the first floor of Our Lady of Victory Convent to operate as assisted living. The license calls for an annual license fee of $1 and a pro-rata share of the operating costs. Total pro-rata share of operating expenses charged to operations under the agreement amounted to $165,840 and $178,573, for the years ended June 30, 2017 and June 30, 2016, respectively.

Effective February 1, 2015, Franciscan Ministries entered into a License Agreement with the Sisters to make available and share certain space in the Sisters' Administration Building to meet the office space needs of Franciscan Ministries. The License Agreement calls for an annual license fee of $1 and a pro-rata share of the operating costs of the building. Total expense charged to operations under the agreement amounted to $181,260 and $107,507 for the year ended June 30, 2017 and 2016, respectively.

As described in Note 1, Franciscan Ministries has land lease agreements with the Sisters to lease land at Franciscan Village and Marian Village, all of which expire on June 30, 2050. Under the terms of amendments to the ground leases, dated May 1, 2014, the annual rent is $1 per year, effective July 1, 2014. Total rent expense charged to operations under these agreements amounted to $156,618 for each of the years ended June 30, 2017 and 2016. At June 30, 2017 and June 30, 2016, the present value of the future contributed rent, net of amortized amounts, amounted to $5,168,308 and $5,324,924, respectively.

On March 10, 2017 the Sisters made a $500,000 restricted donation to Franciscan Ministries. The donation is restricted to capital improvements.

In April 2017, Franciscan Ministries sold its fifty percent (50%) membership interest in Franciscan Home Care Services, Inc. ("Franciscan Home Care"). Franciscan Ministries had accounted for the investment in Franciscan Home Care using the cost method. The sale included proceeds of $1,744,943 and a gain on the sale of the investment of $402,610.

## 14. Employee Benefit Plans

Franciscan Ministries sponsors the Franciscan Ministries 401(k) Defined-Contribution Plan covering substantially all eligible employees. Franciscan Ministries contributed a match of 50 percent of employee contributions to a maximum employer contribution of 3 percent in 2017 and 2016. Franciscan Ministries' total expenses related to the plan were $1,123,772 and $936,194 for the years ended June 30, 2017 and 2016, respectively, and are included in employee benefit expenses in the accompanying consolidated statements of operations and changes in net assets.

## 15. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets include net assets available for the purchase of assets and for specific programs totaling $3,489,566 and $2,441,205 at June 30, 2017 and 2016, respectively. Temporarily restricted net assets also include contributed land lease rights totaling $5,168,308 and $5,324,924 at June 30, 2017 and 2016, respectively.

Permanently restricted net assets have been restricted by donors to be maintained by Franciscan Ministries in perpetuity, the income from which is expendable to support purchases of capital, and amounted to $730,209 at both June 30, 2017 and 2016.

## 16. Functional Expenses

Franciscan Ministries provides comprehensive residential and healthcare services to residents within its geographic location. The expenses related to continuing operations included in the consolidated statements of operations and changes in net assets are primarily related to the following for the years ended June 30:

| | **2017** | **2016** |
|---|---|---|
| Nursing care | **$64,741,413** | $66,936,505 |
| Senior housing | **43,374,499** | 38,770,696 |
| Education and community services | **2,035,751** | 1,994,883 |
| General and administrative | **26,607,945** | 26,750,607 |
| | **$136,759,608** | $134,452,691 |

## 17. Commitments and Contingencies

### Internal Revenue Service Examination

In July 2009, the IRS notified Franciscan Ministries that it will examine Franciscan Ministries' 2007 tax return. The examination was later expanded to include the 2008 tax return and certain employee benefit issues. In January 2012, the IRS notified Franciscan Ministries that the tax returns were accepted; however, certain employee benefits issues are still under examination. Management has no estimate of potential liability, if any, at this time.

### Other Contingencies

Franciscan Ministries is a defendant in a class action lawsuit filed in conjunction with the termination of the St. Anthony Medical Center, Inc. Retirement Plan (the "Plan"). Franciscan Ministries believes that the suit is without merit and intends to vigorously defend its position.

Franciscan Ministries is a defendant in various other legal actions that have arisen in the normal course of business. Franciscan Ministries believes that the eventual resolution of these claims will not have a material effect on Franciscan Ministries' financial position or operations.

On June 1, 2017, Franciscan Communities II entered into a construction contract to build a 42-resident memory care facility on the campus of Mount Alverna Village. The contract sum and remaining balance to finish at June 30, 2017 totaled $5,424,462 and the construction period is estimated at thirteen months.

On March 24, 2017, Franciscan Communities entered into a construction contract to renovate the nursing home at The Village at Victory Lakes. The total contract price is $877,120, with the balance to finish, including retainage of $213,457, at June 30, 2017.

## 18. Guarantees

Franciscan Ministries has agreed to provide an Operating Deficit Guarantee and Tax Credit Guarantee for Crete Senior Housing, LLC, which provides affordable senior housing in Crete, Illinois, on land owned by Franciscan Ministries. The Operating Deficit Guarantee is for a period of three years commencing with stabilization, which has not been met, limited to an amount equal to six months of operating expenses. The Operating Deficit Guarantee will be in the form of an operating loan bearing interest at 4 percent payable upon available cash flow. The Tax Credit Guarantee obligates Franciscan Ministries to reimburse the investor for losses (including interest and penalties) resulting from the recapture of low-income housing tax credits due to the project being operated in a manner inconsistent with the rent and affordability restrictions imposed by Section 42 of the Code. Tax credits will be guaranteed for five years from the issuance of 8609 tax certification. This guarantee would not become operative provided the residents occupying the building are within established income guidelines. The maximum aggregate amount that Franciscan Ministries shall be required to pay under the Operating Deficit Guarantee and the Tax Credit Guarantee is $512,740.

## 18. Guarantees (continued)

Franciscan Ministries has agreed to provide a Tax Credit Guarantee for Louisville Senior Housing, LLC, which provides affordable senior housing in Louisville, Kentucky. The Tax Credit Guarantee obligates Franciscan Ministries to reimburse the investor for losses (including interest and penalties) resulting from the recapture of low-income housing tax credits due to the project being operated in a manner inconsistent with the rent and affordability restrictions imposed by Section 42 of the Code. Tax credits will be guaranteed for five years from the issuance of 8609 tax certification. This guarantee would not become operative provided the residents occupying the building are within established income guidelines. The maximum aggregate amount that Franciscan Ministries shall be required to pay under the Operating Deficit Guarantee and the Tax Credit Guarantee is $823,850.

Franciscan Ministries has agreed to guarantee for Crete Senior Housing Phase II, LLC, which provides affordable senior housing in Crete, Illinois, on land owned by Franciscan Ministries, the payment of the recapture amount pursuant to the Section 1602 Grant documents and the payment of the repayment pursuant to the Home Program documents. The recapture amount under the Section 1602 Grant is eliminated over a 15-year compliance period. As of June 30, 2017 and 2016, the maximum amount due under the guarantee approximates $3,295,000 and $3,452,000, respectively, and is reported as Section 1602 Deferred Grant Revenue under noncurrent liabilities. This guarantee is not anticipated to be used as long as the residents occupying the building are within established income guidelines.

## 19. Self-Insurance Risks

Effective July 1, 2013, Franciscan Ministries is insured for workers' compensation through a fully funded insurance policy with normal statutory limit coverages in Indiana. Franciscan Ministries, prior to July 1, 2013, was self-insured for workers' compensation losses up to a maximum limit of $300,000 per occurrence in Indiana. Franciscan Ministries is self-insured for workers' compensation in Illinois and Kentucky up to a maximum limit of $450,000 per occurrence. Losses over these limits are covered by a supplemental catastrophic policy up to specified limits with an independent insurer. Estimated accruals for workers' compensation, which include estimates of the ultimate costs for both reported claims and claims incurred but not yet reported, were $1,351,744 and $1,549,904 undiscounted, as of June 30, 2017 and 2016, respectively.

Franciscan Ministries provides employee health insurance to its employees through a self-insured program. The self-insured program, implemented July 1, 2009, includes a specific stop-loss deductible of $200,000 per plan participant and an aggregate stop-loss policy with a maximum benefit of $1,000,000. Franciscan Ministries reported insurance claim liabilities of $504,000 and $807,000 as of June 30, 2017 and 2016, respectively, included in accounts payable and employee benefits, and an aggregate stop-loss receivable of $0 and $53,829 as of June 30, 2017 and 2016, respectively, which is included in prepaid expenses and other.

## 20. Community Commitment

The mission, values, and philosophy of Franciscan Ministries are reflected in the programs in place to provide care to the underprivileged population. Franciscan Ministries makes a major commitment to the community and residents in need by providing charity care to residents through the Gift of Care Program, sustaining significant amounts of unreimbursed costs by participation in the Medicaid program, and allocating significant resources to meet a number of community benefit needs identified.

The cost of providing charity care is calculated based upon the total cost-to-charge ratio based upon service line and payor class. The cost of the charity care amounted to $992,000 and $412,000 for the years ended June 30, 2017 and 2016, respectively.

Unreimbursed costs represent the excess of resident care costs over Medicaid reimbursements. The amount of unreimbursed costs over Medicaid reimbursement is calculated based on allocated costs per resident day. Unreimbursed costs amounted to $4,475,000 and $4,354,000 for the years ended June 30, 2017 and 2016, respectively.

Franciscan Ministries addresses the spiritual needs of the community and those served through pastoral care services, including, but not limited to, chapel services. The costs of these pastoral care services amounted to $1,163,000 and $1,198,000 for the years ended June 30, 2017 and 2016, respectively.

## 21. Subsequent Events

Franciscan Ministries evaluated events and transactions occurring subsequent to June 30, 2017 through November 15, 2017, the date of issuance of the consolidated financial statements. During this period, there were certain subsequent events requiring disclosure, which are described below.

On July 31, 2017, Franciscan Communities entered into a construction contract totaling approximately $1,933,000 to expand therapy and life enrichment space at Mount Alverna Village. The construction period is estimated to be nine months.

On September 13, 2017 Franciscan Communities II entered into a Construction Loan Agreement (the "Loan") with a bank ("Bank or Lender") to finance the construction of a 42-resident memory care facility (the "Project") in Parma, Ohio, on property owned by Franciscan Communities. The Loan is in an amount not to exceed $8,000,000 with interest at the LIBOR index rate. Interest only monthly payments are made through September 2020 with principal and interest monthly payments thereafter thru the maturity date of September 2022. Franciscan Ministries is required to contribute not less than $2,056,650. This requirement was met as of September 13, 2017. Franciscan Ministries is a guarantor on the loan and is required to maintain no less than $10,000,000 in cash and investments. Compliance with this covenant shall be measured on the last day of each fiscal year beginning with the fiscal year ended June 30, 2018.

## 21. Subsequent Events (continued)

In addition, Franciscan Communities II has mortgage and security agreements with the Lender as security for the Loan.

## 22. Change in Accounting Principle

As of July 1, 2016, the Organization adopted new guidance related to the presentation of deferred bond issuance costs in its consolidated balance sheet. Under the new guidance, deferred bond issuance costs are reported as a direct deduction from the carrying amount of the related long-term debt. Previously, deferred bond issuance costs were presented as an asset. The new presentation requirements have been applied retrospectively and amounts reported in the 2016 consolidated balance sheet have been restated as follows:

| | 2016 | | |
|---|---|---|---|
| | As Previously Reported | As Reported Under New Method | Effect of Change |
| Assets – Deferred bond issuance costs | $4,517,556 | $ - | ($4,517,556) |
| Liabilities - Long-term debt | $174,767,211 | $ 170,249,655 | $4,517,556 |

Deferred bond costs previously reported as an asset at June 30, 2016 included $1,659,210 of bond discounts that have also been restated to net with the carrying amount of the related long-term debt.

The new guidance does not affect how the deferred bond issuance costs are accounted for after initial recognition, and these amounts continue to be amortized over the term of the related debt. However, the amortization of the deferred bond issuance costs is now required to be reported as a component of interest expense; previously, these amounts were reported as part of depreciation and amortization expense. The consolidated statement of activities for 2016 has been restated to report $186,351 of amortization of deferred bond issuance costs as a component of interest expense

Franciscan Ministries and Affiliates including The Village At Mercy Creek
Pro Forma Statement of Operations
Project - At Stabilization

| | |
|---|---|
| Operating Revenue | |
| Net Resident Service Revenue | 140,767,286 |
| Other Revenue | 15,335,501 |
| Contribution and Grant Revenue | 1,307,765 |
| Management Service Fee Revenue | 1,178,121 |
| Development Fee Revenue | (21,047) |
| **Total Operating Revenue** | **158,567,625** |
| Operating Expenses | |
| Salaries and Wages | 73,728,835 |
| Benefits | 13,956,636 |
| Agency Staffing | 440,982 |
| Purchased Services-Residents | 8,007,535 |
| Purchased Services-Administration | 12,314,144 |
| Drugs, Food, Supplies and Other | 13,089,753 |
| Administrative | 3,909,277 |
| Insurance | 3,289,101 |
| Bad Debts | 1,333,653 |
| Total Controllable Operating Expenses | 130,069,916 |
| Controllable Operating Margin | 28,497,710 |
| Other Operating Expenses | |
| Providers' tax | 1,729,380 |
| Utilities | 4,998,244 |
| Real Estate Taxes | 778,695 |
| Management Fees | 572,490 |
| Land and Building Lease | 641,140 |
| Total Other Operating Expenes | 8,719,950 |
| **Net Operating Income** | **19,777,760** |
| Nonoperating Revenue | |
| Contribution revenue | 206,521 |
| Realized investment revenue | 7,329,657 |
| Trustee held investment earnings | 338,737 |
| Contributed lease revenue | 176,272 |
| Total Nonoperating Revenue | 8,051,186 |
| Net Income Before Long-term Debt Expenses and Noncash Items | 27,828,946 |
| Long-term Debt Expenses | 10,028,063 |
| **Net Income Before Noncash Items** | **17,800,883** |
| Noncash Items | |
| Entrance Fee Revenue Amortization | 1,987,284 |
| Depreciation and Amortization | (14,936,637) |
| Net change in unrealized gains on investments | (226,251) |
| Gain or (loss) on sale of assets | 2,154,918 |
| Total Noncash Items | (11,020,685) |
| **Revenues in Excess (Less than) Expenses** | **$6,780,198.** |

An inflation factor was applied to the FY 2018 unaudited financial statements for Franciscan Ministries and Affiliates to combine with The Village at Mercy Creek after stabilizing.

ADDENDUM 3

Franciscan Ministries and Affiliates including The Village at Mercy Creek
Pro Forma Balance Sheet
Project At Stabilization

| | |
|---|---|
| Assets | |
| Current Assets: | |
| Cash and cash equivalents | $20,532,864. |
| Accounts receivable | $7,803,210. |
| Allowance for uncollectible accounts | ($1,521,314.) |
| Due from affiliates | $867,293. |
| Due from third-party payors | $182,017. |
| Prepaid expenses and other | $4,293,507. |
| Notes Receivable | $1,676,314. |
| Total current assets | 33,833,891 |
| Assets limited as to use, net of amounts required to meet current obligations: | |
| Internally designated for capital improvements | 117,063,902 |
| Externally designated under debt agreements and letters of credit | 20,280,327 |
| Total assets limited as to use, net | 137,344,229 |
| Long-term investments | 400,000 |
| Property, plant and equipment | $172,221,863. |
| Notes Receivable | 5,782,330 |
| Goodwill | 47,735 |
| Other | 2,027,677 |
| Total Assets | $351,657,725. |
| Liabilities and Net Assets | |
| Current Liabilities: | |
| Accounts payable and accrued expenses | $14,911,468. |
| Accrued salaries and employee benefits | $6,003,907. |
| Due to third-party payors | $962,171. |
| Notes payable | $247,817. |
| Current maturities of long-term debt | $3,447,600. |
| Refundable resident deposits and entrance fees | $4,394,527. |
| Total current liabilities | 29,967,490 |
| Noncurrent liabilities: | - |
| Long-term debt, less current maturities | $198,690,607. |
| Refundable resident deposits and refundable and nonrefundable entrance fees | $74,049,775. |
| Other long-term liabilities | $2,163,326. |
| Total noncurrent liabilities | 274,903,708 |
| Total liabilities | 304,871,198 |
| Net Assets (Deficit): | |
| Unrestricted | $37,965,430. |
| Temporarily restricted | $8,164,562. |
| Permanently restricted | $656,535. |
| Total net assets (deficit) | 46,786,527 |
| Total Liabilities and Net Assets (Deficit) | $351,657,725. |

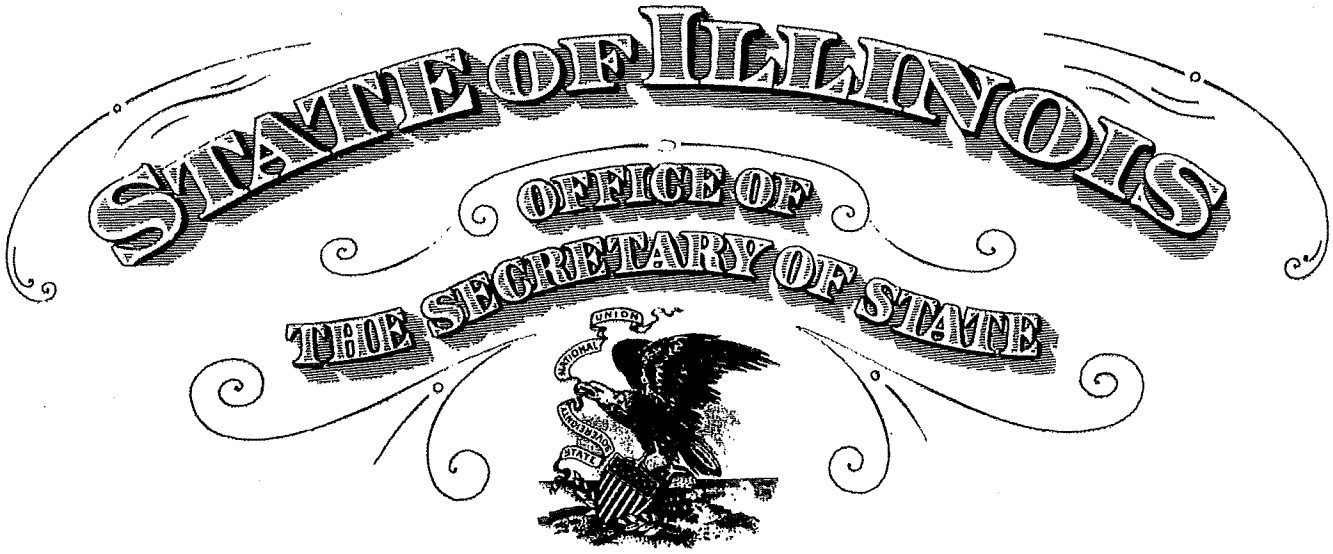
An inflation factor was applied to the FY 2018 unaudited financial statements for Franciscan Ministries and Affiliates to combine with The Village at Mercy Creek at stabilization

Franciscan Ministries and Affiliates with The Village at Mercy Creek
Pro Forma Statement of Cash Flows
Project At Stabilization

| | |
|---|---|
| Operating activities | |
| Change in net assets | $5,496,835. |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | |
| Depreciation and amortization | $13,391,052. |
| Working Capital/Other | 3,454,524 |
| Net cash provided by operating activities | 22,342,411 |
| | |
| Investing activities | |
| Purchases of property and equipment, net | ($9,658,431.) |
| Net (increase) decrease in internally designated investments | ($12,192,730.) |
| Net (increase) decrease in trustee held investements | $1,091,029. |
| Net cash used in investing activities | (20,760,131) |
| | |
| Financing activities | |
| Proceeds from issuance of long-term debt | ($3,694,717.) |
| Payments of long-term debt | $406,801. |
| Proceeds (payments) of notes payable to affiliate | $27,963. |
| Proceeds from restricted contributions and gains on investments, | - |
| net of assets released from restrictions | ($566,987.) |
| | - |
| Additions to unearned entrance fees, net withdrawals | $1,275,220. |
| Change in bond issuance costs | ($166,289.) |
| Transfers to/from affiliates | ($500,000.) |
| Net cash provided by financing activities | (3,218,009) |
| (Decrease) increase in cash and cash equivalents | (1,635,729) |
| Cash and cash equivalents at beginning of period | $22,168,593. |
| Cash and cash equivalents at end of period | $20,532,864. |

Inflation factor applied to the FY 2018 unaudited financial statements for Franciscan Ministries and Affiliates to combine with The Village at Mercy Creek at stabilization

*File Number* 6772-131-4




## *To all to whom these Presents Shall Come, Greeting:*

*I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that I am the keeper of the records of the Department of Business Services. I certify that*

THE VILLAGE AT MERCY CREEK, A DOMESTIC CORPORATION, INCORPORATED UNDER THE LAWS OF THIS STATE ON FEBRUARY 09, 2011, APPEARS TO HAVE COMPLIED WITH ALL THE PROVISIONS OF THE GENERAL NOT FOR PROFIT CORPORATION ACT OF THIS STATE, AND AS OF THIS DATE, IS IN GOOD STANDING AS A DOMESTIC CORPORATION IN THE STATE OF ILLINOIS.

***In Testimony Whereof,*** *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 28TH *day of* AUGUST *A.D.* 2018 .

Authentication #: 1824002582 verifiable until 08/28/2019
Authenticate at: http://www.cyberdriveillinois.com

Jesse White
SECRETARY OF STATE

**THE VILLAGE AT MERCY CREEK**
**Pro forma Statement of Operations**

| | | Initial Stabilized Year |
|---|---|---|
| **Operating Revenue** | | |
| Independent Living | $ | 35,700 |
| Assisted Living | | 3,695,140 |
| Assisted Living Memory Support | | 1,327,258 |
| Nursing | | 4,971,712 |
| Gross Revenue | | 10,029,810 |
| Other Discounts and Gift of Care | | (211,025) |
| Net Resident Service Revenue | | 9,818,785 |
| Total Other Revenue | | 112,704 |
| **Total Operating Revenue** | | **9,931,489** |
| **Operating Expenses** | | |
| Salaries/Benefits | | 4,506,238 |
| Purchased Services | | 1,071,212 |
| Dining | | 384,639 |
| Other Expenses | | 1,442,945 |
| Insurance | | 112,200 |
| Bad Debts | | 24,989 |
| Utilities | | 282,511 |
| Total Other Operating Expenses | | 7,824,734 |
| **Net Operating Income** | | **2,106,755** |
| Total Nonoperating Revenue - Contributions | | 50,000 |
| **Net Income Before Interest and Non-Cash** | **$** | **2,156,755** |
| Interest Expense | | 879,300 |
| **Net Income Before Non-Cash** | | 1,277,455 |
| Depreciation/Amortization | | (1,076,500) |
| **Net Income in Excess of Expenses** | | **200,955** |

Subject to Revision

**THE VILLAGE AT MERCY CREEK**
Pro forma Cash Flow Statements

| | Initial Stabilized Year |
|---|---|
| **Operation Activities** | |
| Change in net assets | $ 200,955 |
| Depreciation/amortization | 1,076,500 |
| Changes in working capital | 1,200 |
| **Net Cash from Operating Activities** | 1,278,655 |
| | |
| **Investing Activities** | |
| Purchase of property, plant, and equip | 50,000 |
| **Net Cash from Investing Activities** | 50,000 |
| | |
| **Financing Activities** | |
| Payments of long-term debt | (555,000) |
| **Net Cash from Financial Activities** | (555,000) |
| | |
| Increase/(decrease) in Cash | 773,655 |
| Cash - Beginning of the Period | 1,495,970 |
| **Cash - End of the Period** | **$ 2,269,625** |

| COMBINED - At Closing | DR | CR | |
|---|---|---|---|
| Cash | 165,000 | | |
| A/R - net | 8,100 | | |
| Prepaid | 15,950 | | |
| Land, Building, Equipment | 15,750,000 | | per bank appraisal |
| A/P | | 46,900 | |
| Accrued salaries | | 24,000 | |
| Accrued interest | | 32,000 | |
| Real estate escrow | | 14,450 | |
| EF - IL units | | 884,330 | |
| EF - AL unit | | 148,500 | |
| Security deposits | | 92,000 | |
| Employee benefits reserves | | 19,250 | |
| Assume Loyalty loan | | 353,000 | |
| Assume Soy loan | | 9,680,475 | as of 7/10/2018 |
| Assume Augustian loan | | 296,640 | |
| FM - Inherent contribution equity | | 4,347,505 | |
| | 15,939,050 | 15,939,050 | |

**THE VILLAGE AT MERCY CREEK**
Pro forma Balance Sheet

| | | Initial Stabilized Year |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash | $ | 2,269,625 |
| Accounts Receivable - Net | | 36,180 |
| **Total Current Assets** | | **2,305,805** |
| | | |
| **Long-Term Assets** | | |
| Fixed Assets | | 23,759,737 |
| **Total Long-Term Assets** | | **23,759,737** |
| | | |
| **Total Assets** | **$** | **26,065,542** |
| | | |
| **Liability and Net Assets** | | |
| **Current Liabilities** | | |
| Accounts Payable | $ | 47,610 |
| Accrued Expenses | | 90,720 |
| **Total Current Liabilities** | | **138,330** |
| | | |
| **Long-Term Liabilities** | | |
| Resident Deposits/Entrance Fees | | 1,124,830 |
| Debt | | 19,701,800 |
| **Total Long-Term Liabilities** | | **20,826,630** |
| | | |
| **Total Liabilities** | | **20,964,960** |
| | | |
| **Net Assets** | | |
| Unrestricted Assets | | 5,100,582 |
| **Total Net Assets** | | **5,100,582** |
| | | |
| **Total Liabilities and Net Assets** | **$** | **26,065,542** |

| COMBINED - At Closing | DR | CR | |
|---|---|---|---|
| Cash | 165,000 | | |
| A/R - net | 8,100 | | |
| Prepaid | 15,950 | | |
| Land, Building, Equipment | 15,750,000 | | per bank appraisal |
| A/P | | 46,900 | |
| Accrued salaries | | 24,000 | |
| Accrued interest | | 32,000 | |
| Real estate escrow | | 14,450 | |
| EF - IL units | | 884,330 | |
| EF - AL unit | | 148,500 | |
| Security deposits | | 92,000 | |
| Employee benefits reserves | | 19,250 | |
| Assume Loyalty loan | | 353,000 | |
| Assume Soy loan | | 9,680,475 | as of 7/10/2018 |
| Assume Augustian loan | | 296,640 | |
| FM - Inherent contribution equity | | 4,347,505 | |
| | 15,939,050 | 15,939,050 | |

*Discontinuation of Beds. The parties acknowledge that pursuant to that certain transaction with FSCSC referenced in Section 5, upon the written request of FSCSC, and in any event prior to any sale or other transfer of the Facilities' assets to a third party, the Company shall use commercially reasonable efforts to discontinue forty (40) of the SNF skilled nursing facility beds, including but not limited to submitting documentation to the Illinois Department of Public Health ("**IDPH**") and the Illinois Health Facilities and Services Review Board. Notwithstanding anything to the contrary contained in this Agreement, Company's covenant with FSCSC to discontinue forty (40) of the SNF skilled nursing facility beds shall survive the closing of any of transactions contemplated by this Agreement, or any other agreement, and shall be enforceable by the Company and FSCSC notwithstanding any subsequent change in control of the Company. The transfer of beds to FSCSC must be completed within twenty-four (24) months or all terms and conditions related to the discontinuation of beds shall become null and void.*

**2.10 Illinois Health Facilities and Services Review Board.** Upon the written request of Franciscan, and in any event prior to any sale or other transfer of assets to a third party, MMRC shall use commercially reasonable efforts to discontinue forty (40) of the Chenoa Facility skilled nursing facility beds, including but not limited to submitting documentation to the Illinois Department of Public Health ("**IDPH**") and the Illinois Health Facilities and Services Review Board. Notwithstanding anything to the contrary contained in this Agreement, MMRC's covenant to discontinue forty (40) of the Chenoa Facility skilled nursing facility beds shall survive the closing of the transactions contemplated by this Agreement and shall be enforceable by the Villas and/or Franciscan notwithstanding any subsequent change in control of MMRC. MMRC agrees to provide Franciscan not less than thirty (30) days' prior written notice of any sale or other transfer of assets or closure of the Chenoa Facility or change in control of MMRC.

**The Village at Mercy Creek**
**CON Application**
**Appendix D**

| | | Gross Square Footage | | Amount of Gross Square Feet that is | | |
|---|---|---|---|---|---|---|
| | Costs | Existing | Proposed | New Construction | Modernization | As-Is |
| **Reviewable** | | | | | | |
| Resident Rooms | $ 4,547,889 | | 18,186 | 18,186 | NA | NA |
| Nursing Stations/Common | $ 478,800 | | 1,915 | 1,915 | NA | NA |
| Living/Dining/Activity | $ 1,158,500 | | 4,634 | 4,634 | NA | NA |
| Kitchen/Food Service | $ 75,500 | | 302 | 302 | NA | NA |
| PT/OT | $ 139,800 | | 559 | 559 | NA | NA |
| Laundry | $ 177,500 | | 710 | 710 | NA | NA |
| Janitor Closets | $ 52,000 | | 208 | 208 | NA | NA |
| Cleaned/Soiled Utility | $ 155,000 | | 620 | 620 | NA | NA |
| Beauty/Barber | $ 255,800 | | 1,023 | 1,023 | NA | NA |
| **Total Reviewable** | **$ 7,040,789** | **-** | **28,157** | **28,157** | | |
| **Non-Reviewable** | | | | | | |
| Resident Rooms | $ 3,448,211 | | 13,790 | 13,790 | NA | NA |
| Office/Admin | $ 181,800 | | 727 | 727 | NA | NA |
| Employee Lounge | $ 40,300 | | 161 | 161 | NA | NA |
| Locker room/Training | $ 50,300 | | 201 | 201 | NA | NA |
| Mechanical/Electrical | $ 219,800 | | 879 | 879 | NA | NA |
| Lobby | $ 146,300 | | 585 | 585 | NA | NA |
| Storage/Maintenance | $ 29,500 | | 118 | 118 | NA | NA |
| Corridor/Public Toilets | $ 283,000 | | 1,132 | 1,132 | NA | NA |
| Stair/Elevators | $ - | | - | - | NA | NA |
| **Total Non-reviewable** | **$ 4,399,211** | **-** | **17,593** | **17,593** | | |
| **Combined Total** | **$ 11,440,000** | **-** | **45,750** | **45,750** | | |

Advocate BroMenn Medical Center

1304 Franklin Avenue || Normal, IL 61761 || T 309.454.1400 || advocatehealth.com

August 15, 2018

Ms. Courtney Avery, Administrator
Illinois Health Facilities and Services Review Board
525 West Jefferson Street
Springfield, IL 62761

Dear Ms. Avery,

I would like to support The Village of Mercy Creek's application for a Certificate of Need to establish a 40-bed long-term care skilled nursing facility to be located west of Towanda Barnes Road and North of East Raab road in Normal Illinois. I believe The Village of Mercy Creek provides a very important service to the Bloomington-Normal area.

Geographically, the location will be ideal for some of the elderly who live in this area. This project will provide outstanding services to residents of this community. I believe The Village of Mercy Creek will fill a needed gap in skilled nursing for the area. Thank you so much for considering The Village of Mercy Creek for the addition of these nursing beds. I wish the best and offer our support in their endeavor.

Respectfully,

Colleen Kannaday, FACHE
President

Meadows

Meadows Mennonite Retirement Community
24588 Church Street • Chenoa, Illinois 61726
p : 309-747-2702 f: 309-747-2944

Meadows at Mercy Creek
1501 Mercy Creek Drive • Normal, Illinois 61761
p : 309-268-1501 f: 309-268-1498

Ms. Courtney Avery Administrator
Health Facilities and Services Review Board
Illinois Department of Public Health
525 W. Jefferson Street, Second Floor
Springfield, IL 62761

RE: Application for Certificate of Need for Village at Mercy Creek – Normal, IL
40 Bed Skilled Nursing and Memory Care in Normal, IL

Dear Ms. Avery,

As you may know, the Village at Mercy Creek – a Franciscan Ministries (FM) community is proposing to build a 40 bed skilled rehabilitation and healthcare center on the campus previously owned and operated by the Meadows Mennonite Retirement Communities (MMRC). I serve as the Board Chair for MMRC.

Please be advised that the purchase of Mercy Creek was completed on August 9 2018, and that we chose FM as partners because of our shared mission. We are excited to know that they will be developing a full continuum of care ranging from Independent Living to Skilled care. As the Bloomington/Normal IL population continues to expand, the demand for skilled care will only grow. There is especially a shortage of communities that provide appropriate care for residents needing advanced dementia services. We anticipate the need for quality skilled services will only grow in the coming years in the Bloomington/Normal area. I support the Village at Mercy Creek's addition of this 40 bed facility.

Thank you for giving this Certificate of Need application every consideration. Please feel free to contact me directly should you have any further questions.

Sincerely,

Mary J. Dyck

Mary J. Dyck, PhD, RN, LNHA
MMRC Board Chair