Baystate Health, Inc. and Subsidiaries

Consolidated Financial Statements as of and
for the Years Ended September 30, 2014 and 2013,
and Independent Auditors' Report

Baystate Health, Inc. and Subsidiaries

Table of Contents

Deloitte & Touche LLP
200 Berkeley Street
Boston, MA 02116
USA

Tel: +1 617 437 2000
Fax: +1 617 437 2111
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Baystate Health, Inc.:

We have audited the accompanying consolidated financial statements of Baystate Health, Inc. and Subsidiaries ("Baystate Health"), which comprise the consolidated statements of financial position as of September 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the 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.

Auditors' 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free of 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 Baystate Health'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 Baystate Health'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 Baystate Health, Inc. and Subsidiaries as of September 30, 2014 and 2013, and the results of their operations, their changes in net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

December 23, 2014

Baystate Health, Inc. and Subsidiaries

Consolidated statements of financial position
as of September 30, 2014 and 2013
(In thousands)

Assets	**2014**	**2013**
Current assets:		
Cash and cash equivalents	$ 179,075	$ 144,893
Investments	327,655	342,682
Accounts receivable, patients, less allowance for uncollectible accounts of $31,547 in 2014 and $30,217 in 2013	138,689	113,697
Accounts receivable, other	36,312	33,278
Estimated final settlements receivable	15,867	28,347
Inventories	26,048	20,881
Prepaid expenses and other current assets	23,343	16,001
Total current assets	746,989	699,779
Long-term assets:		
Investments	57,842	56,377
Equity investment in unconsolidated affiliates	2,737	2,507
Notes receivable	67,846	67,050
Deferred expense and other long-term assets	20,266	16,694
Land, buildings, and equipment, net	657,095	610,749
	805,786	753,377
Assets whose use is limited:		
Board-designated funds:		
Cash and investments	255,333	234,254
Investments of captive insurance company	108,467	105,995
Investments held by trustee under debt agreements	1,297	1,335
Beneficial interest in perpetual trusts	37,388	35,118
Deferred compensation investments	35,889	30,139
	438,374	406,841
Total assets	$ 1,991,149	$ 1,859,997

Liabilities and net assets	**2014**	**2013**
Current liabilities:		
Accounts payable	$ 112,065	$ 91,517
Medical claims payable	48,573	52,954
Accrued salaries and wages	100,212	89,801
Accrued interest payable	2,251	2,247
Estimated final settlements payable	55,141	61,838
Refundable advances	515	616
Deferred revenue	14,150	10,252
Current portion of long-term debt	7,840	6,513
Current portion of capital lease obligations	3,541	3,007
Total current liabilities	344,288	318,745
Long-term debt	457,081	432,550
Capital lease obligations	9,864	12,608
Pension liability	99,502	78,552
Insurance liabiilty loss reserves	126,059	126,793
Other liabilities	42,770	38,174
Total liabilities	1,079,564	1,007,422
Net assets:		
Unrestricted:		
Operating	1,034,366	940,070
Pension adjustment	(231,272)	(193,715)
Total unrestricted	803,094	746,355
Temporarily restricted	54,611	54,775
Permanently restricted	53,880	51,445
Total net assets	911,585	852,575
Total liabilities and net assets	$ 1,991,149	$ 1,859,997

See notes to consolidated financial statements.

Baystate Health, Inc. and Subsidiaries

Consolidated statements of operations
For the years ended September 30, 2014 and 2013
(In thousands)

	2014	2013
Operating revenues:		
Net patient service revenue	$1,171,589	$1,099,705
Bad debts	23,918	21,736
Net patient service revenue, net of bad debts	1,147,671	1,077,969
Premiums	590,083	547,220
Other revenue	84,108	83,877
Net assets released from restrictions for operations	5,192	7,333
Total operating revenues	1,827,054	1,716,399
Operating expenses:		
Salaries and wages	715,502	666,158
Supplies and expense	586,322	558,466
Medical claims and capitation	393,965	370,001
Depreciation and amortization	63,404	60,255
Interest expense	10,591	11,284
Total operating expenses	1,769,784	1,666,164
Income from operations	57,270	50,235
Non-operating income:		
Investment income	5,391	7,050
Net realized gain on investments	11,807	7,188
Net unrealized gain on investments	21,446	28,561
Equity gain (loss) in unconsolidated affiliates	48	(33)
Net interest cost on swap agreements	(2,220)	(2,423)
Change in fair value of swap agreements	1,141	3,788
Net assets from acquired subsidiary	2,164	
Income taxes and other	(9,770)	(22,874)
Total non-operating income	30,007	21,257
Excess of revenues over expenses	87,277	71,492
Other changes in unrestricted net assets:		
Net assets released from restrictions for capital	4,336	3,916
Funds utilized for property and equipment	2,810	-
Transfers to restricted net assets	(157)	(785)
Pension adjustment	(37,558)	92,316
Other	31	(343)
Increase in unrestricted net assets	$ 56,739	$ 166,596

See notes to consolidated financial statements.

Baystate Health, Inc. and Subsidiaries

Consolidated statements of changes in net assets
For the years ended September 30, 2014 and 2013
(In thousands)

	2014	2013
Unrestricted net assets:		
Excess of revenues over expenses	$ 87,277	$ 71,492
Net assets released from restrictions for capital	4,336	3,916
Funds utilized for property and equipment	2,810	-
Transfers to restricted net assets	(157)	(785)
Pension adjustment	(37,558)	92,316
Other	31	(343)
Increase in unrestricted net assets	56,739	166,596
Temporarily restricted net assets:		
Restricted investment income	362	195
Net realized and unrealized gain on investments	3,603	4,644
Contributions	4,231	4,664
Transfers from unrestricted net assets	157	785
Net assets released from restrictions:		
For operations	(5,192)	(7,333)
For capital	(4,336)	(3,916)
Net assets from acquired subsidiary	1,161	-
Other	(150)	28
Decrease in temporarily restricted net assets	(164)	(933)
Permanently restricted net assets:		
Contributions	5	53
Change in value of perpetual trusts	47	1,229
Net assets from acquired subsidiary	2,383	-
Increase in permanently restricted net assets	2,435	1,282
Increase in net assets	59,010	166,945
Net assets — beginning of year	852,575	685,630
Net assets — end of year	$ 911,585	$ 852,575

See notes to consolidated financial statements.

Baystate Health, Inc. and Subsidiaries

Consolidated statements of cash flows
For the years ended September 30, 2014 and 2013
(In thousands)

	2014	2013
Operating activities:		
Increase in net assets	$ 59,010	$ 166,945
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	63,404	60,255
Accretion on notes receivable	(1,366)	(1,350)
Pension adjustment	37,558	(92,316)
Net realized and unrealized gain on investments	(35,590)	(40,865)
Provision for bad debts	24,281	24,736
Change in beneficial interest of perpetual trusts	(47)	(1,229)
Restricted contributions	(4,176)	(4,717)
Changes in equity investment of affiliate	242	(237)
Net assets from acquired subsidiary	(5,707)	-
Changes in operating assets and liabilities:		
Accounts receivable, patients	(41,604)	(17,661)
Net estimated final settlements	6,153	(9,409)
Accounts payable and accrued expenses	15,567	(15,153)
Pension liability, net	(16,606)	(9,574)
Medical claims payable	(1,062)	7,840
Insurance liability loss reserves	(1,396)	23,026
Other	(15,811)	(2,427)
Net cash provided by operating activities	82,850	87,864
Investing activities:		
Proceeds from sale and maturities of investments	840,604	888,384
Purchase of investments	(796,614)	(896,200)
Acquisition of BWH	(40,500)	-
Proceeds from asset sale	2,648	-
Cash acquired in acquisition of BWH	3,717	-
Purchase of land, buildings, and equipment	(71,806)	(68,681)
Net cash used in investing activities	(61,951)	(76,497)
Financing activities:		
Proceeds from restricted contributions	4,176	4,717
Repayment (issuance) of notes receivable	570	(2,430)
Proceeds from debt issuance	32,245	-
Repayments of debt and capital lease obligations	(23,708)	(9,221)
Net cash provided by (used in) financing activities	13,283	(6,934)
Net increase in cash and cash equivalents	34,182	4,433
Cash and cash equivalents — Beginning of year	144,893	140,460
Cash and cash equivalents— End of year	$ 179,075	$ 144,893
Supplemental cash flow information:		
Cash paid for interest	$ 10,649	$ 11,906
Capital lease obligations	$ 1,230	$ -

See notes to consolidated financial statements.

1. Organization

Baystate Health, Inc. ("Baystate Health" or BH), based in Springfield, Massachusetts, is the parent corporation of an integrated health care delivery system with the mission "to improve the health of the people in our community every day, with quality and compassion."

Baystate Health currently includes the following:

- Baystate Medical Center, Inc. (BMC), located in Springfield, Massachusetts, is the largest of the four hospitals in the Baystate Health system. BMC, the leading health facility in western Massachusetts, is the only tertiary care referral medical center and Level I trauma center in the region. It is also home to western New England's only neonatal and pediatric intensive care units. BMC is a 710-bed, tax-exempt, not-for-profit, academic teaching hospital that serves as the western campus of Tufts University School of Medicine.

- Baystate Total Home Care, Inc. (BTHC), is a tax-exempt, not-for-profit corporation, which is organized to benefit, support, and further the charitable activities of BMC by holding, leasing, improving, and managing real estate held by, or acquired on behalf of, BMC. BTHC serves as the operating entity in connection with the new markets tax credit financing for the BMC Expansion Project.

- Baystate Franklin Medical Center, Inc. (BFMC), located in Greenfield, Massachusetts, is a 90-bed, tax-exempt, not-for-profit, acute care community hospital. BFMC serves the northern tier of northwestern Massachusetts and southern Vermont.

- Baystate Wing Hospital Corporation (BWH), located in Palmer, Massachusetts, is a 74-bed, tax-exempt, not-for-profit, acute care community hospital acquired in 2014.

- Baystate Mary Lane Hospital Corporation (BMLH), located in Ware, Massachusetts, is a 25-bed, tax-exempt, not-for-profit, acute care community hospital. BMLH provides services to more than 16 central Massachusetts communities.

- Baystate Medical Practices, Inc. (BMP), is a tax-exempt, not-for-profit organization formed in 2010. BMP includes a multispecialty academic group practice established to support the educational and research programs of Baystate Health, as well as numerous primary care and outreach services. BMP also includes community-based primary care (internists and pediatricians), medical and surgical practices, obstetrical and gynecological, and hospitalist physicians dedicated to the care and management of patients hospitalized at BH-affiliated hospitals. BMP also provides preventative, diagnostic, and therapeutic health services enhancing the cardiovascular clinical, educational, community, and research activities for BH and its service area.

- Baystate Visiting Nurse Association & Hospice (BVNAH) is a tax-exempt, not-for-profit organization that provides comprehensive home health care committed to providing the highest quality care to patients and families, primarily in the home setting. BVNAH meets individual needs by bringing experienced nurses, rehabilitation therapists, social workers, and home care aides to patients' homes.

- Health New England, Inc. (HNE), is a not-for-profit health maintenance organization located in Springfield, Massachusetts. HNE's service area in Massachusetts includes Franklin, Berkshire, Hampden, and Hampshire counties, and part of Worcester County. HNE also serves Hartford, Litchfield, and Tolland counties in Connecticut. In 2013, HNE converted from a for-profit to a not-for-profit organization and has filed an application for tax-exempt status, which is pending with the Internal Revenue Service (IRS).

- Ingraham Corporation (IC) is a for-profit, taxable corporation that currently serves as a holding company for Baystate Health Ambulance, Inc.

- Baystate Health Ambulance, Inc. (BHA) is a for-profit, taxable corporation that delivered mobile critical care providing 24-hour service throughout western New England. On May 24, 2014, BH exited this business line through a sale of all BHA's fixed assets to a third party.

- Baystate Administrative Services, Inc. (BAS), is a tax-exempt, not-for-profit corporation that provides management support for the BH subsidiaries, including human resources, marketing, strategic planning, information services, and financial services.

- Baystate Health Foundation, Inc. (BHF), is a tax-exempt, charitable organization established for the purpose of fund-raising for healthcare-related activities, in support, and for the benefit, of BH and those subsidiaries of BH that are tax-exempt, not-for-profit corporations, and to hold endowment, charitable donations, and other funds for their benefit.

- Baystate Health Insurance Company, Ltd. (BHIC), is a captive insurance company organized and licensed in the Cayman Islands, British West Indies. BHIC provides professional liability and other insurance coverage to the corporate members of BH and their employees. In 2004, BHIC began offering malpractice insurance to members of BH's medical staff who meet criteria for participation.

2. Significant accounting policies

Principles of Consolidation — The accompanying consolidated financial statements include the accounts of BH and its subsidiaries noted above. All intercompany and subsidiary accounts and 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 and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made in the areas of the allowance for uncollectible patient accounts receivable, reserve for contractual allowances, investment valuation, accruals for settlements with third-party payers, medical claims payable, accrued insurance liability loss reserves, income taxes, pension costs, and the fair value of assets acquired and liabilities assumed (see Note 3).

Net Assets — Baystate Health and its subsidiaries report net assets and revenues, expenses, gains, and losses based upon the existence or absence of donor-imposed restrictions. In the accompanying consolidated financial statements, net assets that have similar characteristics have been combined into the following categories:

Unrestricted — Net assets that are not subject to donor-imposed stipulations. Net assets may be designated for specific purposes by action of the Board of Trustees, or may otherwise be limited by contractual agreements with outside parties.

Temporarily Restricted — Net assets whose use by Baystate Health and its subsidiaries are subject to donor-imposed stipulations that can be fulfilled by actions of Baystate Health and its subsidiaries, or that expire by the passage of time. At September 30, 2014 and 2013, temporarily restricted net assets consist of amounts restricted as to spending for various purposes, such as education, research, clinical, and health care programs, as well as cumulative net appreciation of permanent endowment funds which is available for governing board appropriation.

Permanently Restricted — Net assets subject to donor-imposed stipulations that they be maintained permanently by Baystate Health and its subsidiaries. At September 30, 2014 and 2013, permanently restricted net assets consist of the original cost of permanent endowment gifts and beneficial interests in perpetual trusts.

Revenues from sources other than donor-restricted contributions are reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Expirations of temporary restrictions recognized on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications from temporarily restricted net assets to unrestricted net assets. Temporary restrictions on gifts to acquire long-lived assets are considered met in the period in which the assets are acquired or placed in service.

Contributions, including unconditional promises to give and grant awards, are recognized as revenues in the period received. Contributions received with donor-imposed restrictions are reported as permanently or temporarily restricted revenues, depending upon the specific restriction. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair values at the date of the gift. Contributions to be received after one year are discounted at a risk-free rate commensurate with the expected payment term. Amortization of the discount is recorded as contribution revenue in the appropriate net asset category. Allowance is made for uncollectible contributions based upon management’s judgment and analysis of the creditworthiness of the donors, past collection experience, and other relevant information.

Cash and Cash Equivalents — Cash and cash equivalents include all highly liquid investments with a maturity of three months or less when purchased.

Investments — Investments include cash equivalents, mutual funds, fixed-income securities, as well as interests in limited partnerships and common collective trusts. Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at estimated fair value in the consolidated statements of financial position. The accounting for the investments held by the pension plan is discussed in Note 16.

Baystate Health has also entered into partnership agreements with limited partnerships (“alternative investments”), the majority of which are in private markets, whereby they have agreed to certain capital commitments. Baystate Health’s policy is to record its ownership interest in these alternative investments of less than 5% at the lower of cost or market. For those alternative investments where the ownership interest is more than 5%, the ownership interests are reported using the equity method of accounting. As of September 30, 2014, approximately $28,981,000 of total capital commitments, including those held within the pension plan assets discussed in Note 16, remain outstanding. Certain of the partnerships may hold some securities without readily determinable fair values and, consequently, the general partner may estimate fair value for such securities. These estimates may differ significantly from the values that would have been used had a ready market existed, and may also differ significantly from the values at which such investments may be sold, and the differences could be material.

Interest and dividends on investments are included in other revenue or nonoperating income in the consolidated statements of operations unless the income or loss is restricted by donor or law. Realized gains and losses and unrealized gains and losses on investments are included in nonoperating income or temporarily restricted net assets, as applicable. Investment-related expenses, such as custodial fees and investment fees, are netted against investment revenues and are immaterial for the years ended September 30, 2014 and 2013.

Baystate Health and its subsidiaries have elected the fair value option for certain of their investments. Baystate Health made this election to reflect changes in fair value of its investments, including both increases and decreases and whether realized or unrealized, in its excess of revenue over expenses. Baystate Health recognized net unrealized gains on investments totaling $21,446,000 and $28,561,000 in 2014 and 2013, respectively, within the excess of revenues over expenses.

Investments are included in pooled investment funds. Current market value is used to determine the percent of each fund in the pool. Income from investments of a pool, including gains or losses, is allocated to participating funds based on the respective fund's percentage of the pool.

Inventories — Inventories are stated at the lower of cost (principally first-in, first-out method) or market.

Notes Receivable — In December and May 2009, BMC loaned $31,186,783 and $32,617,500, respectively, to a third party relating to project costs of approximately $252,000,000 for the construction of a new hospital facility at 759 Chestnut Street, Springfield, Massachusetts. The loans are part of a financing arrangement that utilizes new markets tax credits (NMTC) to reduce cash required by BMC to construct this new facility. Each loan bears interest at 2.139% annually, with annual cash payments during the first seven years of the 33-year term based on an interest rate of 1.00%. The notes are recorded as notes receivable in the consolidated statements of financial position as of September 30, 2014 and 2013.

Equity Investment in Unconsolidated Affiliates — Baystate Health participates in joint ventures with 50% or less ownership, and accounts for the investment in those unconsolidated affiliates as equity investments.

Deferred Expenses and Other Long-Term Assets — Deferred expenses include unamortized bond issuance expenses, which are amortized over the weighted-average terms of the bonds.

Goodwill is included within other long-term assets and is assessed annually for indicators of impairment on July 1 of each year. There were no such indicators in the years ended September 30, 2014 and 2013.

Assets Whose Use is Limited — Assets whose use is limited include assets held by the trustee under indenture agreements and designated assets set aside by the Board of Trustees for future capital improvements and other strategic initiatives, which are in furtherance of Baystate Health and its subsidiaries' exempt and charitable purposes. Also included are investments of the captive insurance company, deferred compensation investments, and beneficial interests in perpetual trusts.

Land, Buildings, and Equipment — Land, buildings, and equipment are stated at cost, less depreciation and amortization determined on the straight-line basis.

Maintenance and repairs are charged to expense as incurred. Betterments and major renewals are capitalized. Cost of assets sold or retired and the related amounts of accumulated depreciation are eliminated from the accounts in the year of disposal, and the resulting gain or loss is included in other revenue. Buildings and equipment under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life. Useful life is assigned in accordance with the American Hospital Association's guide, *Estimated Useful Lives of Depreciable Hospital Assets*. Such amortization is included in depreciation and amortization in the consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Consolidated Statements of Operations — All activities of Baystate Health deemed by management to be ongoing and central to the provision of health care services are reported as operating revenues and expenses. Other activities are considered nonoperating, and include board-designated investment income and realized gains and losses, unrealized gains and losses on investments, investment return on deferred compensation plan investments and related compensation expense, changes in BHIC loss reserves, equity gains and losses in unconsolidated affiliates, contributions of net assets from acquired subsidiaries, interest on swap agreements, changes in fair value of swap agreements, income taxes, and acquisition related costs associated with the purchase of BWH.

The consolidated statements of operations include excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, include net assets released from restrictions for capital, transfers to restricted net assets, and the pension adjustment.

Net Patient Service Revenue — Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payers, and others for services rendered, and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Contracts, laws, and regulations governing Medicare, Medicaid, Blue Cross, and the Health Safety Net (HSN) programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Blue Cross and other managed care plans have negotiated with Baystate Health and its subsidiaries various forms of contractual payment rates. The most common payment rates include discounted charges, per case, per diems, and fee schedules.

Medicaid payment rates are negotiated between the Division of Medical Assistance and individual hospitals. Medicare Prospective Payment System (PPS) regulations determine payment due acute care hospitals for inpatient services provided to Medicare beneficiaries. Medicare payments for outpatient services are a blend of PPS and fee schedules.

During 2014 and 2013, Baystate Health recorded adjustments to amounts accrued for settlements related to prior fiscal years. The net effect of such adjustments was an increase to net patient service revenue by approximately $23,610,000 and $24,535,000 in 2014 and 2013, respectively.

Medicare and Medicaid Electronic Health Record (EHR) Program — Certain health care providers can earn up to four incentive payments between federal fiscal years 2011 and 2016 if certain specific program criteria are met. The providers are required to establish an EHR system and maintain its meaningful use status for a continuous 90-day period. In subsequent years, such meaningful use must be maintained for the entire 365-day federal fiscal year. Baystate Health records the revenue related to this program when management is reasonably assured that Baystate Health has complied with the terms of the program.

Baystate Health has included approximately $6,398,000 and $8,894,000 in other revenue related to the program in fiscal years 2014 and 2013, respectively. The estimate is based on cost report data, which is subject to audit, and the amounts recognized are subject to change. Baystate Health's attestation of compliance with the meaningful use criteria is subject to audit by the federal or state government or its designee.

Premium Revenue — Premium revenue represents insurance membership contract revenue at HNE. The contracts generally cover a 12-month period and are subject to cancellation by the employer group or HNE upon 30 days' written notice. Premiums are due monthly and are recognized as revenue during the period in which HNE is obligated to provide services to members.

Health Safety Net — In April 2006, the Commonwealth of Massachusetts passed Chapter 58 of the Acts of 2006, "An Act Providing Access to Affordable, Quality, Accountable Health Care;" the goal of which is to provide near-universal health insurance coverage to Massachusetts residents through a combination of Medicaid expansions, subsidized private insurance programs, insurance market reforms, and the HSN.

The HSN reimburses hospitals for uncompensated care based on actual services provided at rates approximating the PPS, subject to available funds. Like its predecessor, the Uncompensated Care Pool, the HSN is partially funded by acute hospitals through an assessment on gross charges billed to nongovernmental payers.

Charity Care and Community Support — It is the policy of Baystate Health to provide care to any patient in need of medical care, regardless of the patient's ability to pay for such care. Based upon the patient's financial capability to pay, such care is provided free of charge or at amounts below normal charges. Because amounts determined to qualify as charity care are not pursued, they are not reported as revenue. The net cost of charity care includes the direct and indirect cost of providing charity care services, offset by revenues received from indigent care pools (primarily the HSN). The cost is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated care charges associated with providing charity care.

The costs of charity care provided during the years ended September 30, 2014 and 2013, are as follows (in thousands):

	2014	2013
HSN assessment	$ 5,452	$ 5,278
HSN receipts	(9,192)	(11,389)
Free care (at cost)	12,642	20,362
Total	$ 8,902	$ 14,251

In addition to the charity care provided to patients, Baystate Health and its subsidiaries have ongoing community outreach initiatives in the areas of health services access, education, safety, and community reinvestment. The initiatives include free-standing health centers, improving school-based health services, implementing an immunization tracking system to link preschool-aged children to primary care providers, youth development programs, increasing minority employment, improving the community's health status, wellness, health and safety programs for senior citizens, and health screenings and forums.

Allowance for Uncollectible Accounts — Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, Baystate Health analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, Baystate Health analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for bad debts, if necessary. For receivables associated with self-pay patients, Baystate Health records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

Baystate Health's allowance for uncollectible accounts for self-pay patients increased from 96% of self-pay accounts receivable at September 30, 2013, to approximately 100% of self-pay accounts receivable at September 30, 2014. In addition, Baystate Health's self-pay write-offs, net of recoveries decreased $285,000 from $46,818,000 for fiscal year 2013 to $46,533,000 for fiscal year 2014. Baystate Health has not changed its charity care or uninsured discount policies during fiscal year 2013 or 2014. Baystate Health does not maintain a material allowance for uncollectible accounts from third-party payers, nor did it have significant write-offs from third-party payers. Baystate Health recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, Baystate Health recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy).

Net patient service revenue (after contractual allowances and discounts) recognized during the years ended September 30, 2014 and 2013, from Baystate Health's major payer sources is as follows (in thousands):

	2014	2013
Medicare	$ 463,884	$ 438,706
Medicaid	240,412	215,665
Commercial and other	450,813	421,597
Self-pay	16,480	23,737
Total	$1,171,589	$1,099,705

Impairment of Long-Lived Assets — Long-lived assets to be held and used are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value, less cost to sell.

Research Grants and Contracts — Revenue related to research grants and contracts is recognized as the related costs are incurred. Indirect costs relating to certain government grants and contracts are reimbursed at fixed rates negotiated with the government agencies. Research grants and contracts have been accounted for as exchange transactions. Amounts received in advance of incurring the related expenditures are recorded as unexpended research grants and are included with refundable advances and deferred revenue in the accompanying consolidated balance sheets.

Accounting for Defined Benefit Pension and Other Postretirement Plans — Baystate Health recognizes the overfunded or underfunded status of its defined benefit and postretirement plans as an asset or liability in its consolidated balance sheets. Changes in the funded status of the plans are reported as a change in unrestricted net assets presented below the excess of revenues over expenses in the consolidated statements of operations and changes in net assets in the year in which the changes occur.

Income Taxes — All of Baystate Health's consolidated entities are recognized by the IRS as tax-exempt, not-for-profit organizations under Section 501(c)(3) of the Internal Revenue Code, except for BHIC, IC and its subsidiary, and HNE and its subsidiaries. On December 20, 2012, HNE's shareholders voted to convert HNE from a for-profit stock corporation to a 501(c) (4) not-for-profit corporation. In 2013 HNE filed an application for tax-exempt status. Prior to the acquisition of BWH on September 1, 2014, BWH was exempt from income tax under UMass Memorial Healthcare's Group Exemption. BWH applied through the submission of Form 1023 for stand-alone tax-exempt status pursuant to IRC Section 501(c)(3) in December, 2014.

Immaterial Correction — During 2014, management concluded that the Baystate Health 457(b) deferred compensation plan (the "Plan") assets and corresponding liability to the Plan participants should be included in the consolidated financial statements. The previously issued 2013 consolidated financial statements excluded the investment assets and related liability of $30,139,000 and also excluded the investment income of approximately $3,314,000 and compensation expense of the same amount with no net impact on either income from operations or the excess of revenues over expenses in the consolidated statements of operations. Baystate Health does not believe the omission of these amounts was material to the 2013 consolidated financial statements, taken as a whole, but has corrected the 2013 consolidated financial statements to include such amounts and related benefit plan and asset fair value disclosures in the consolidated financial statements for the year ended September 30, 2014.

3. Acquisition

Effective September 1, 2014, Baystate Health acquired Wing Memorial Hospital and Medical Centers (Wing) of Palmer, Massachusetts from UMass Memorial Healthcare. Wing was renamed Baystate Wing Hospital Corporation (BWH) following the acquisition. The 74 bed hospital and its five community medical centers are focused on high quality patient-centered care delivery by physicians specializing in 45 medical disciplines. The acquisition of Wing is expected to have a positive impact on quality, access and affordability of healthcare in western Massachusetts. Cash consideration of $40,500,000 was paid in connection with the Wing acquisition.

The consolidated statement of operations for 2014 includes the operations of BWH since the date of acquisition. In 2014, the consolidated statement of operations includes total operating revenues of approximately $7,480,000 related to BWH and excess of revenues over expenses of approximately $860,000.

This transaction was accounted for as an acquisition in accordance with Accounting Standards Update (ASU) No. 2010-07, *Not-for-profit Entities: Mergers and Acquisitions*, which required the assets and liabilities of Wing to be accounted for at fair value, as of the date of acquisition. The excess of the fair value of the net assets at the date of acquisition of Wing over the cash consideration paid was recognized as a contribution of net assets from acquired subsidiaries and is included in non-operating gains.

The amounts assigned to Wing's major assets and liabilities at the acquisition date are as follows (in thousands):

Fair value of assets acquired:	
Current assets	$ 37,448
Property, plant, and equipment	38,281
Other noncurrent assets	3,241
Total	78,970
Fair value of liabilities assumed:	
Current liabilities	18,350
Long-term liabilities	14,412
Total	32,762
Fair value of net assets acquired	46,208
Purchase price	40,500
Contribution of net assets from acquired subsidiary	$ 5,708

Costs related to the acquisition totaled approximately $4,370,000 and are included in other non-operating expenses in the consolidated statement of operations.

The fair value adjustments required to account for the Wing acquisition have been recorded in BWH's financial statements.

4. Cash, investments, and assets whose use is limited

The composition of cash, investments, and assets whose use is limited at September 30, 2014 and 2013, is as follows (in thousands):

	2014	2013
Cash and cash equivalents	$ 158,937	$ 154,706
Mutual funds	358,479	356,554
Common collective trusts	94,898	90,559
Fixed-income securities	185,561	160,923
Limited liability investments	131,529	117,185
Alternative investments — limited partnerships	33,610	35,748
Domestic equity securities	2,544	-
Beneficial interests in perpetual trusts	37,388	35,118
	$ 1,002,946	$ 950,793

Cash, investments, and assets whose use is limited at September 30, 2014 and 2013, are included in the consolidated statements of financial position as follows (in thousands):

	2014	2013
Cash and cash equivalents	$ 179,075	$ 144,893
Investments	327,655	342,682
Long-term investments	57,842	56,377
Board-designated cash and investments	255,333	234,254
Investments of captive insurance company	108,467	105,995
Investments held by trustee under debt agreements	1,297	1,335
Beneficial interests in perpetual trusts	37,388	35,118
Deferred compensation investments	35,889	30,139
	$ 1,002,946	$ 950,793
Investment income included in other revenue	$ 11,717	$ 8,543

5. Fair value measurements

Baystate Health calculates fair value as described in ASC 820-10, *Fair Value Measurement*, to value its financial assets and liabilities, when applicable. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a three-level valuation hierarchy that prioritizes observable and unobservable inputs used to measure fair value. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 — Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2 — Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

Level 3 — Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, Baystate Health utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, as well as consider counterparty credit risk in its assessment of fair value.

Financial assets and liabilities carried at fair value for the years ended September 30, 2014 and 2013, are classified in the table below in one of the three categories described above (in thousands):

	Assets at Fair Value at September 30, 2014			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 158,937	$ -	$ -	$ 158,937
Mutual funds:				
Corporate bond fund	164,310	-	-	164,310
Deferred compensation investments:				-
Corporate bond fund	5,421	-	-	5,421
Other	30,468	-	-	30,468
Other	151,084	7,196	-	158,280
Total mutual funds	351,283	7,196	-	358,479
Common collective trusts:				
International equity	-	17,743	-	17,743
Domestic equity index funds	-	71,883	-	71,883
Commodity fund	-	5,272	-	5,272
Total common collective trusts	-	94,898	-	94,898
Limited liability investments:				
Hedge funds	-	-	68,942	68,942
Emerging markets equity	-	15,693	-	15,693
International equity	-	32,559	-	32,559
Other	-	14,335	-	14,335
Total limited liability investments	-	62,587	68,942	131,529
Fixed-income securities —				
Corporate bonds & U.S. government securities	-	185,561	-	185,561
Total fixed-income securities	-	185,561	-	185,561
Domestic equity securities	2,544	-	-	2,544
Beneficial interests in perpetual trusts	-	-	37,388	37,388
Total assets at fair value	$ 512,764	$ 350,242	$ 106,330	969,336
Alternative investments (at cost)				33,610
Financial assets, including alternatives				$ 1,002,946
Liabilities — interest rate swap agreements	$ -	$ 5,806	$ -	$ 5,806

	Assets at Fair Value at September 30, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 154,706	$ -	$ -	$ 154,706
Mutual funds:				
Corporate bond fund	183,405	-	-	183,405
Deferred compensation investments:				
Corporate bond funds	5,185	-	-	5,185
Other	24,954	-	-	25,954
Other	136,190	6,820	-	143,010
Total mutual funds	349,734	6,820	-	356,554
Common collective trusts:				
International equity	-	7,704	-	7,704
Domestic equity index funds	-	60,060	-	60,060
Commodity fund	-	22,795	-	22,795
Total common collective trusts	-	90,559	-	90,559
Limited liability investments:				
Hedge funds	-	-	62,859	62,859
Emerging markets equity	-	14,290	-	14,290
International equity	-	32,367	-	32,367
Other	-	7,669	-	7,669
Total limited liability investments	-	54,326	62,859	117,185
Fixed-income securities —				
Corporate bonds & U.S. government securities	-	160,923	-	160,923
Total fixed-income securities	-	160,923	-	160,923
Beneficial interests in perpetual trusts	-	-	35,118	35,118
Total assets at fair value	$ 504,440	$ 312,628	$ 97,977	915,045
Alternative investments (at cost)				35,748
Financial assets, including alternatives				$ 950,793
Liabilities — interest rate swap agreements	$ -	$ 6,916	$ -	$ 6,916

The amounts classified in the tables above exclude assets invested in Baystate Health's defined benefit plan and limited partnership interests that Baystate Health has recorded at cost.

A summary of changes in the fair value of the Level 3 assets for the years ended September 30, 2014 and 2013, is as follows (in thousands):

2014	Hedge Funds	Beneficial Interest in Perpetual Trusts	Total
Balance at beginning of year	$ 62,859	$ 35,118	$ 97,977
Unrealized gains relating to investments still held at the reporting date	5,843	1,451	7,294
Realized gain on investments sold	240	-	240
Transfers in of BWH assets	-	2,175	2,175
Sales	-	(1,356)	(1,356)
Balance at end of year	$ 68,942	$ 37,388	$ 106,330

2013	Hedge Funds	Beneficial Interest in Perpetual Trusts	Total
Balance at beginning of year	$ -	$ -	$ -
Correction of prior year classification	63,123	33,888	97,011
Unrealized gains relating to investments still held at the reporting date	3,882	1,230	5,112
Realized gain on investments sold	2,676	-	2,676
Sales	(6,822)	-	(6,822)
Balance at end of year	$ 62,859	$ 35,118	$ 97,977

2012 Leveling Disclosure Errors Corrected in 2013 — During 2013, Baystate Health determined that there were errors in the classification of certain financial instruments within the fair value hierarchy presented for September 30, 2012. The classifications have been corrected out of period at the beginning of fiscal year 2013. A summary of the corrections in as follows (in thousands):

	Increase (Decrease)
Level 1	$ (173,689)
Level 2	139,800
Level 3	97,011
Alternative investments, at cost	(63,122)

Transfers between Levels — The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. For the years ended, September 30, 2014 and 2013, there were no transfers between levels, other than the correction of the prior year disclosure errors discussed above.

A summary of investments (by major class) with a reported NAV that have restrictions on Baystate Health's ability to redeem its investment at the measurement date as of September 30, 2014 and 2013, is as follows (in thousands):

	September 30, 2014		
Description of Investment	**Fair Value**	**Redemption Frequency**	**Redemption Notice Period**
Commingled equity mutual funds	$ 112,465	Monthly	5 days
Commingled emerging markets funds	32,610	Monthly	15 days
Commingled commodity funds	19,607	Monthly	30 days
Hedge fund of funds	66,394	Annually	65–95 days
Hedge fund of funds	2,548	Every three years	65–95 days

	September 30, 2013		
Description of Investment	**Fair Value**	**Redemption Frequency**	**Redemption Notice Period**
Commingled equity mutual funds	$ 136,627	Monthly	5 days
Commingled emerging markets funds	30,416	Monthly	15 days
Commingled commodity funds	38,995	Monthly	30 days
Commingled fixed-income funds	84,259	Monthly	30 days
Hedge fund of funds	60,540	Annually	60–65 days
Hedge fund of funds	2,319	Every three years	60–95 days

Valuation Techniques — Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis. There have been no changes in the methodologies used at September 30, 2014 and 2013.

The fair value of investments is determined in accordance with the current fair value guidance and as described below. Net asset value (NAV) would not be used as a practical expedient for fair value when it is determined to be probable that the investment would sell for an amount different than the reported net asset value. In such situations, management would estimate the fair value of the investment in good faith based on the available information and will update the fair value methodology if a significant event occurs which has the potential of impacting the ultimate value of the investment.

Cash Equivalents — The carrying value of cash equivalents approximates fair value as maturities are less than three months and/or include money market funds that are based on quoted prices and are actively traded.

Mutual Funds — The fair values of mutual funds are based on quoted market prices or net assets value. These funds are required to publish their NAV and to transact at that price. The mutual funds held by Baystate Health are deemed to be actively traded.

Common Collective Trusts — The fair value of common collective trusts are based on the NAV of the fund, representing the fair value of the underlying investments, which are generally securities traded on an active market. The NAV is used as a practical expedient to estimate fair value. Such investments are classified as Level 2 when Baystate Health has the ability to redeem its investment in the fund at the NAV (or its equivalent) at the measurement date or within the near term and there are no other potential liquidity restrictions.

Limited Partnerships — The estimated fair values of limited partnerships, for which no quoted market prices are readily available, are determined based upon the information provided by the fund managers. Such information is generally based on NAV of the fund, which is used as a practical expedient to estimate fair value. Baystate Health has classified certain of its investments reported at NAV as Level 2 because it has the ability to redeem its investment in the fund at the NAV per share (or its equivalent) at the measurement date or within the near term and there are no other potential liquidity restrictions. Funds categorized within Level 3 are subject to a minimum holding period or lockup, cannot be redeemed at the measurement date or with 90 days thereof, are subject to redemption notice periods in excess of 90 days, or have the ability to limit the aggregate amount of shareholder redemptions. The limited partnerships allocate gains, losses, and expenses to the partners based on the ownership percentage as described in the respective partnership or hedge fund agreements.

Fixed-income Securities — Certain bonds are valued at the closing price reported in the active market in which the bond is traded. Other bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical or similar bonds, the bond is valued under a discounted cash flow approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.

Domestic Equity Securities — The fair value of domestic equity securities are principally based on quoted market prices that are traded in an active market.

Beneficial Interest in Perpetual Trusts — The estimated fair values of Baystate Health's beneficial interests in perpetual trusts are determined based upon information provided by the trustees. Such information is generally based on the pro rata interest in the net assets of the underlying investments. The assets held in trust consist primarily of cash equivalents and marketable securities. The fair values of the perpetual trusts are measured using the fair value of the assets contributed to the trusts. The measurement for a beneficial interest in a perpetual trust is categorized as a Level 3 fair value measurement because Baystate Health will never receive the trust's assets.

Interest Rate Swaps — Baystate Health uses inputs other than quoted prices that are observable to value the interest rate swaps. Baystate Health considers these inputs to be Level 2 inputs in the context of the fair value hierarchy. The fair values represent the estimated amounts Baystate Health would receive or pay to terminate agreements, taking into consideration current interest rates and the current creditworthiness of the counterparty.

The following methods and assumptions were used by Baystate Health in estimating the fair value of its financial instruments that are not measured at fair value on a recurring basis for disclosures in the consolidated financial statements:

Receivables and Payables — The carrying value of Baystate Health's receivables and payables approximates fair value, as maturities are short term.

Long-Term Debt — The estimated fair value of Baystate Health's bonds is based on current traded value or a discounted cash flows analysis based on Baystate Health's current incremental borrowing rates for similar types of borrowing arrangements. The fair value inputs for long-term debt are considered to be Level 2.

6. Pledges receivable

Pledges receivable at September 30, 2014 and 2013, are as follows (in thousands):

	2014	2013
Receivable in less than one year	$ 2,587	$ 3,388
Receivable in one to five years	1,906	3,540
Receivable in more than five years	44	-
Total pledges receivable	4,537	6,928
Less allowance for uncollectible pledges	(423)	(818)
Net pledges receivable	$ 4,114	$ 6,110

Net pledges receivable are included in accounts receivable, other on the consolidated statements of financial position.

7. Land, buildings, and equipment

Details of land, buildings, and equipment at September 30, 2014 and 2013, are as follows (in thousands):

	2014	2013
Land, land improvements, and leasehold improvements	$ 47,938	$ 43,524
Buildings	761,003	711,418
Fixed equipment	98,710	96,434
Moveable equipment	559,627	517,565
Assets under capital leases	28,633	28,754
Construction in progress	19,054	11,311
	1,514,965	1,409,006
Less accumulated depreciation and amortization	(857,870)	(798,257)
Total land, buildings, and equipment — net	$ 657,095	$ 610,749

Depreciation expense for the years ended September 30, 2014 and 2013, was $63,389,000 and $59,937,000, respectively. As of September 30, 2014 and 2013, the accumulated depreciation on equipment under capital lease is $15,001,000 and $12,415,000, respectively.

8. Short-term obligations and commitments

Baystate Health has a 50% ownership in Baycare Health Partners, Inc. ("Baycare"), a physician hospital organization. Baystate Health has provided an unconditional guarantee for a $1,000,000 line of credit from a financial institution. There were no amounts outstanding under the line of credit at September 30, 2014 and 2013. This line of credit expires July 30, 2015.

At September 30, 2014 and 2013, a financial institution has issued irrevocable letters of credit on behalf of BHIC totaling $1,300,000. As of September 30, 2014, investments with a fair value of approximately $2,853,000 (2013 — $2,834,000) have been pledged as security for these letters of credit. The letters of credit are subject to annual renewal and there are no amounts outstanding under the letters of credit as of September 30, 2014 and 2013.

9. Leases

Baystate Health and its subsidiaries lease certain real property and equipment under noncancelable leases expiring at various dates through 2023 with varying renewal options. Rentals generally include insurance and maintenance costs.

On November 2, 2011, BMC entered into a tax-exempt lease financing agreement with the Massachusetts Development Finance Agency (MDFA) and a financial institution in the amount of $20,000,000. Proceeds from the financing were used to fund certain equipment, some of which is related to the BMC Expansion Project. Interest on the borrowing is fixed at 2.19% with principal and interest payments due monthly until maturity on November 2, 2018. This lease is classified as a capital lease and is included in the table below.

Future minimum lease payments at September 30, 2014, are as follows (in thousands):

Year Ending September 30	Capital Leases	Operating Leases
2015	$ 3,821	$ 12,626
2016	3,527	7,499
2017	3,085	4,896
2018	3,084	3,866
2019	513	3,025
Thereafter	-	1,032
Total minimum lease payments	14,030	$ 32,944
Less amount representing interest	(625)	
Present value of net minimum lease payments	13,405	
Less current portion	(3,541)	
Long-term portion	$ 9,864	

Rental expense of operating leases amounted to approximately $16,208,000 and $14,529,000 for the years ended September 30, 2014 and 2013, respectively.

10. Long-term debt

BMC and BFMC have loan agreements with the MDFA (effective October 1, 2010, Massachusetts Health and Educational Facilities Authority (MHEFA) merged into MDFA) and with the MHEFA for construction projects and equipment. Long-term obligations outstanding at September 30, 2014 and 2013, consist of the following (in thousands):

	Amount Outstanding	
	2014	2013
MDFA and MHEFA issues:		
BMC Series M	$ 37,997	$ 39,097
BMC Series L	23,534	24,096
BMC Series I	63,380	63,380
BMC Series J-1	45,000	45,000
BMC Series J-2	45,000	45,000
BMC Series K-1	20,045	20,045
BMC Series K-2	26,365	26,365
BMC Series M-2	7,138	7,722
BMC Series H	4,889	5,555
BFMC Series M-4A	5,937	6,362
BMC Series G	46,630	49,815
BTHC NMTC debt	107,710	107,628
	433,625	440,065
BH note payable	18,500	-
BWH note payable	13,745	-
Less original issue discount	(949)	(1,002)
Total long-term debt	464,921	439,063
Less current portion	(7,840)	(6,513)
Long-term debt, excluding current portion	$ 457,081	$ 432,550

Summary information for each issue is as follows:

Series M Bonds — On August 9, 2012, BMC issued Series M MDFA Revenue Bonds in the aggregate principal amount of $40,137,000. BMC used the proceeds from the bonds to redeem 100% of Series F MHEFA Revenue Bonds, exercising an early redemption option related to the Series F obligation. The bonds are subject to mandatory tender on August 8, 2022. Interest on the bonds is fixed at 2.37% through August 8, 2022, with final maturity on July 1, 2033. An average balance of $15,000,000 must be maintained or the interest rate on such bonds may be adjusted upward, not to exceed 2.97%

The Series F bonds were issued on June 1, 2002, to reimburse and fund certain capital renovation and equipment expenditures and fund the construction of a new cancer center known as the D'Amour Center for Cancer Care.

Series L Bonds — On November 2, 2011, BMC issued Series L MDFA Revenue Bonds in the aggregate principal amount of $25,000,000. Proceeds from the bonds were used to fund the construction of a new emergency department in conjunction with the BMC Expansion Project. Interest on the bonds is initially fixed at 2.95% through November 1, 2021, with final maturity on July 1, 2041.

BMC Hospital Expansion MHEFA Bond Issuances — On June 25, 2009, BMC issued Series I, J-1, J-2, K-1, and K-2 MHEFA Revenue Bonds in a combined aggregate principal amount of $199,790,000. Proceeds from the bonds were used to pay off the Bank of America, NA loan of $65,000,000 (borrowed in October 2008), and fund the construction, improvement, equipping, and other related capital expenditures of a seven-story building located at 759 Chestnut Street in Springfield, Massachusetts ("BMC Expansion Project"). Details of the related MHEFA bond issuances are as follows:

Series I Bonds — BMC issued Series I MHEFA Revenue Bonds in the aggregate amount of $63,380,000. Interest rates range from 5.5% to 5.75%. Final maturity on the bonds is July 1, 2036.

Series J-1 Bonds — BMC issued Series J-1 MHEFA Revenue Bonds in the aggregate amount of $45,000,000. Interest on the bonds is variable and was 0.04% and 0.08% at September 30, 2014 and 2013, respectively. Final maturity on the bonds is July 1, 2044. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates in January 2017.

Series J-2 Bonds — BMC issued Series J-2 MHEFA Revenue Bonds in the aggregate amount of $45,000,000. Interest on the bonds is variable and was 0.04% and 0.08% at September 30, 2014 and 2013, respectively. Final maturity on the bonds is July 1, 2044. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates in January 2017.

Series K-1 Bonds — BMC issued Series K-1 MHEFA Revenue Bonds in the aggregate amount of $20,045,000. The bonds are subject to mandatory tender on July 1, 2013. The initial interest on the bonds is fixed at 5.0% through June 30, 2013, with final maturity on July 1, 2039.

On July 1, 2013, the Series K-1 MHEFA Revenue Bonds were purchased pursuant to the mandatory tender and remarketed on such date. The reoffering of the bonds contained a conversion of the interest rate from the long-term fixed rate to a daily rate, 0.02% at September 30, 2014, along with a provision of a letter of credit from a financial institution. The daily rate at September 30, 2013 was 0.04%. The daily interest rate is determined by the remarketing agent and the letter of credit will expire on October 1, 2016.

Series K-2 Bonds — BMC issued Series K-2 MHEFA Revenue Bonds in the aggregate amount of $26,365,000. The bonds are subject to mandatory tender on July 1, 2015. The initial interest on the bonds is fixed at 5.0% through June 30, 2015, with final maturity on July 1, 2039.

Series M-2 — On June 30, 2008, BMC entered into a loan commitment under a Capital Asset Program financed by MHEFA through the issuance of variable-rate demand Revenue Bonds, Series M-2. Proceeds of $10,158,000 were used to refund the then-outstanding Revenue Bonds, BMC Issue, Series J-2, which were issued in 1995 ("Series J-2-1995"). The Series J-2-1995 bonds were issued to reimburse and fund certain capital renovation and equipment expenditures, and fund the purchase of an office building. Interest on the Series M-2 bonds is variable, and resets weekly to reflect current market rates, and was 0.06% and 0.12% at September 30, 2014 and 2013, respectively. Final maturity of the bonds is June 15, 2023.

Series H Bonds — On January 18, 2007, BMC issued Series H MHEFA Revenue Bonds in the aggregate principal amount of $10,000,000. Proceeds from the bonds were used to reimburse and fund certain capital additions, and fund the construction of a new parking garage. Interest on the bonds is variable based on monthly resets, and was .88% and 0.97% at September 30, 2014 and 2013, respectively. Final maturity of the bonds is January 1, 2022.

Series M-4A Bonds — On February 1, 2005, BFMC entered into a loan commitment under a Capital Asset Program financed by MHEFA through the issuance of variable rate demand Revenue Bonds, Series M-4A. Proceeds of $9,100,000 were used to fund certain capital additions, renovations, and equipment expenditures related to the emergency department, radiology department, and in-patient facilities. Interest on the bonds is variable, and resets weekly to reflect current market rates, and was 0.06% and 0.12% at September 30, 2014 and 2013, respectively. Final maturity of the bonds is June 15, 2024.

Series G Bonds — On October 27, 2005, BMC issued Series G MHEFA Revenue Bonds in the aggregate principal amount of $71,740,000. Proceeds from the bonds were used to advance refund a portion of the outstanding Revenue Bonds, BMC Issue, Series E. The Series E bonds were issued to finance or refinance the following: (a) construction of a new 104,500 gross square foot Ambulatory Care Center; (b) construction of a new 100,000 gross square foot building to house the Ambulatory Surgery Center, Medical Library, and education space; (c) renovation of various existing spaces within BMC; and (d) acquisition of equipment for the new facilities. Series G bond proceeds were also used to finance routine capital construction, renovations, and equipping of various facilities of BMC. Interest on the bonds is variable, and resets every 35 days and was 0.03% and 0.04% at September 30, 2014 and 2013, respectively. Final maturity of the bonds is July 1, 2026. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates November 13, 2017.

New Markets Tax Credit Debt — In December and May 2009, BMC entered into financing arrangements with U.S. Bancorp Community Development Corporation (“U.S. Bancorp”), Banc of America Community Development Corporation (“Banc of America”), and MHIC New Markets Fund II, LLC (MHIC) to fund a portion of the costs of the construction of a new hospital facility (BMC Expansion Project) in Springfield, Massachusetts, using the New Markets Tax Credit Program (“NMTC Program”). The NMTC Program is a program of the Community Development Financial Institutions Fund, a bureau of the United States Treasury. The NMTC Program permits taxpayers to receive a credit against federal income taxes for making qualified equity investments in designated Community Development Entities (CDEs).

In connection with the December and May 2009 financing arrangements, BMC loaned $23,580,283 and $32,617,500, respectively, to USBCDE Investment Fund XXXIII, LLC (the “Investment Fund”), a wholly owned subsidiary of U.S. Bancorp. The notes bear interest at 2.139% annually, with annual cash payments during the first seven years of each 33-year term based on an interest rate of 1.00%. Also in connection with the December 2009 financing arrangement, BMC loaned $7,606,500 to MHIC. The note bears interest at 1% annually, with no cash payments during the first seven years of the 33-year term. The notes are recorded as notes receivable in the consolidated statements of financial position as of September 30, 2014 and 2013.

Under the December 2009 financing arrangement, BTHC has borrowed $37,692,500 from four CDEs established for the purpose of providing funds under the NMTC Program. U.S. Bancorp through the Investment Fund controls two of the CDEs and MHIC controls the other two. As of September 30, 2014 and 2013, BTHC has outstanding loans of $27,490,000 and $10,202,500 due to U.S. Bancorp CDEs and MHIC CDEs, respectively, related to the December 2009 financing. The loans were issued in four tranches from each of the controlling entities. U.S. Bancorp loans were issued in tranches A, B, C, and

D. The U.S. Bancorp CDEs A loan totaled $19,886,783, the B loan $2,653,217, the C loan $3,693,500, and the D loan $1,256,500. Each of the loans has a 33-year term, and bear interest at rates ranging from 0.8911% to 1.8315% annually. MHIC loans were issued in tranches A, B, Series 2, and Series 4. The MHIC CDEs A loan totaled $7,606,500, the B loan $1,366,000, the Series 2 loan $1,000,000, and the Series 4 loan $230,000. Each of the loans has a 33-year term, and bear interest at rates ranging from 1.00% to 1.935%.

Under the May 2009 financing arrangement, BTHC has borrowed approximately $69,424,000 from CDEs established for the purpose of providing funds under the NMTC Program. U.S. Bancorp, through the Investment Fund, controls four of the CDEs and Banc of America controls the other CDE. As of September 30, 2014 and 2013, BTHC has outstanding loans of approximately $43,340,000 and $26,084,000 due to U.S. Bancorp CDEs and Banc of America CDE, respectively. The loans were issued in two tranches, an A tranche and a B tranche. The A loans from the U.S. Bancorp CDEs totaled $32,617,500, have a 33-year term, and bear interest at rates ranging from 0.816% to 1.00% annually. The B loans from the U.S. Bancorp CDEs totaled $10,722,500, have a 33-year term, and bear interest at rates ranging from 0.5% to 1.2832% annually. The A loan from the Banc of America CDE of $20,000,000 has a seven-year term and bears interest at 5.992% annually. The B loan from the Banc of America-controlled CDE of $6,084,000 has a seven-year term, and provides that if there has been no default, the principal balance will be forgiven at the end of the seven-year term. The B loan bears interest at 2.00% annually. Interest payments are due quarterly.

Certain buildings and equipment have been pledged as collateral for the borrowings.

BMC recorded interest income of approximately $1,366,000 in 2014 and $1,350,000 in 2013, respectively, related to the financing arrangement agreements. No interest was capitalized at BTHC in 2014 and 2013 relating to the financing arrangement agreements.

In 2016, U.S. Bancorp may put its interest in the Investment Fund to BMC for a put price of $1,000. If U.S. Bancorp does not exercise its put rights, BMC may call its interest in the Investment Fund for a call price equal to the fair value of U.S. Bancorp's interest in the Investment Fund.

Significant Debt Covenants — The bond agreements include various financial covenants, the most restrictive of which are a pledge of revenues and the maintenance of a ratio of Net Revenue Available to Meet Debt Service to Total Principal and Interest Requirements of at least 1.1 (as defined by the agreement). Baystate Health was in compliance with those covenants during the fiscal years ended September 30, 2014 and 2013.

A debt service fund has been established in accordance with these agreements. Debt services fund balances amounted to approximately $1,297,000 at September 30, 2014, and $1,335,000 at September 30, 2013.

BH Note Payable — On August 29, 2014, BH entered into a variable rate, 10-year term loan through a financial institution in the amount of $18,500,000. The interest rate on this term-loan is equivalent to London InterBank Offered Rate (LIBOR) plus 0.475%. The interest rate on this loan was 0.635% on September 30, 2014. Proceeds from the term loan were used in the financing of BH's September 1, 2014 purchase of BWH. Cash and short-term investments have been pledged as collateral for this borrowing.

BWH Note Payable — On September 30, 2014, BWH entered into a 10-year loan through a financial institution in the amount of $13,745,000 at a fixed rate of 3.542%. Proceeds from the loan were used to repay debt held by BWH in the same amount at a rate of 5.15%.

The combined aggregate future principal payments of all long-term borrowings are as follows (in thousands):

Year Ending September 30	
2015	$ 7,840
2016	28,801
2017	11,053
2018	11,638
2019	11,963
Thereafter	394,575
	$ 465,870

BMC has entered into a guaranty agreement on behalf of BFMC and BWH, respectively, in connection with outstanding MHEFA bonds and BWH term loan.

The fair value of the bonds payable at September 30, 2014 and 2013, approximates $478,240,000 and $442,726,000, respectively.

Interest paid was $10,649,000 and $11,906,000 for 2014 and 2013, respectively.

Interest Rate Swap Agreements — BMC periodically enters into interest rate swap agreements to moderate its exposure to interest rate changes and to lower the overall cost of borrowings. Gains and losses realized on termination of contracts are deferred and amortized over the remaining life of the associated contract.

BMC entered into an interest rate swap agreement with a financial institution with an original notional amount of $67,470,000. The notional amount outstanding at September 30, 2014 and 2013, was $23,985,000 and $29,394,000, respectively. Under the terms of the agreement, BMC pays a fixed rate of 3.26%, and receives variable payments based upon the SIFMA Rate. The agreement, in effect, converts $29,394,000 of notional variable-rate debt to fixed-rate debt.

In September 2005, BMC, in anticipation of the issuance of the Series G bonds, entered into an interest rate swap agreement with a financial institution with an original notional amount of $71,740,000. The notional amount outstanding at September 30, 2014 and 2013, was $46,630,000 and $49,815,000, respectively. The agreement provides for the financial institution to pay variable-rate payments to BMC equal to 56.9% of one-month LIBOR plus 0.32%, and for BMC to pay the financial institution a fixed rate of 3.021%. The LIBOR was 0.15% and 0.18% at September 30, 2014 and 2013, respectively. The agreement, in effect, converts $46,630,000 of variable rate debt to a fixed rate of interest. There are termination provisions to this contract for each party.

The fair value of these agreements resulted in swap liabilities of approximately $5,806,000 and $6,916,000 at September 30, 2014 and 2013, respectively, and is included in other long-term liabilities in the consolidated statements of financial position.

The net interest cost and the change in the fair value of the associated interest rate swaps are included in nonoperating income in the consolidated statements of operations.

11. Interest expense

Baystate Health and its subsidiaries capitalize interest cost as part of the historical cost of acquiring certain significant qualifying assets. During the years ended September 30, 2014 and 2013, interest cost was as follows (in thousands):

	2014	2013
Total interest cost	$ 10,741	$ 11,776
Net interest cost capitalized	(150)	(492)
Net interest cost expensed	$ 10,591	$ 11,284

12. Insurance liability loss reserves

Baystate Health, with the exception of HNE, addresses its professional and general liability expense, in part, by depositing funds with BHIC, which utilizes these funds to pay claims and, in part, to purchase commercial excess liability insurance. The commercial insurance generally provides coverage on a “claims-made” basis. Under the claims-made policies, claims based on occurrences during their term by reported subsequently will be uninsured should the policy not be renewed or replaced with other coverage. Management has the intention of renewing its insurance policies in the future and believes it will have the ability to obtain such policy renewals. Baystate Health and certain of its subsidiaries have also purchased excess professional and general coverage from other insurers. In addition, BHIC insures the workers’ compensation, employer’s liability, excess workers’ compensation, and long-term disability of certain of Baystate Health’s subsidiaries.

BHIC reinsures a portion of its risks in order to limit its exposure to losses. Reinsurance contracts do not relieve Baystate Health from its obligations to policy holders. Failure of reinsurers to honor their obligations could result in losses to Baystate Health. Consequently, Baystate Health evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

Reinsurance recoverables were based on actuarial reports prepared by independent consulting actuaries. At September 30, 2014, reinsurance recoverables of $13,050,000 were recorded as deferred expense and other long-term assets. There were no specifically identified claims subject to reinsurance recoverables at both September 30, 2014 and September 30, 2013, or deducted from losses incurred and paid during the years then ended.

Reserves have been provided with the assistance of a consulting actuary for asserted claims and for unasserted claims probable of assertion arising from both reported and unreported incidents, which are based on historical experience and existing reported incidents.

Activity in the BHIC liability for losses and loss adjustment expenses for the years ended September 30, 2014 and 2013 is summarized as follows (in thousands):

	2014	2013
Balance at beginning of year	$ 16,498	$ 18,760
Incurred (recovered) related to:		
Current year	3,100	3,500
Prior years	(3,480)	(3,130)
Total incurred	(380)	370
Paid related to:		
Current year	(44)	(20)
Prior years	(531)	(2,612)
Total paid	(575)	(2,632)
Balance at end of year	$ 15,543	$ 16,498

13. Medical claims and capitation expense

Medical claims and capitation expense for the years ended September 30, 2014 and 2013, include the following components (in thousands):

	2014	2013
Physician and other outpatient specialty services	$ 203,213	$ 192,258
Inpatient care and same-day surgery	73,128	69,759
Pharmacy	92,973	75,987
Primary care capitation	4,416	4,265
Other medical services	17,515	17,100
Coordination of benefits	(332)	(447)
Net reinsurance losses	1,477	2,364
	392,390	361,286
Provider risk-sharing — net	1,575	8,715
Total medical claims and capitation expense	$ 393,965	$ 370,001

Activity in medical claims payable for 2014 and 2013 is as follows (in thousands):

	2014	2013
Medical claims payable:		
Claims payable, beginning of year	$ 41,882	$ 38,778
Risk-sharing payable, beginning of year	11,072	6,336
	52,954	45,114
Reclassification of other medical claims payable	-	6,857
Claims incurred:		
Current year	398,514	389,429
Prior years	(1,909)	2,498
	396,605	391,927
Claims paid:		
Current year	(369,875)	(354,128)
Prior years	(31,111)	(36,816)
	(400,986)	(390,944)
Risk-sharing payable, end of year	13,286	11,072
Medical claims payable, end of year	35,287	41,882
Total medical claims payable	$ 48,573	$ 52,954

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled.

14. Income taxes

Income tax expense for the years ended September 30, 2014 and 2013, for HNE and its subsidiaries, was approximately $95,000 and $10,311,000, respectively. Net federal and state deferred tax assets totaled approximately $40,000 and $25,000 as of September 30, 2014 and 2013, respectively. There is no valuation allowance recorded.

In 2013, HNE reorganized and converted to a not-for-profit corporation effective January 1, 2013. HNE has submitted an application to the IRS seeking recognition of tax exemption under Section 501(c)(4) of the Internal Revenue Code as of January 1, 2013. The IRS's review of the application is in its early stages, and they may submit questions and/or requests for additional information to HNE before it renders a decision on the application. Baystate Health believes that, based on the merits of the HNE exemption request application, it is more likely than not that the IRS will grant the exemption. Accordingly, Baystate Health has accounted for HNE income tax consequences on the assumption that it will become tax exempt effective January 1, 2013. HNE's income tax provision for 2013 includes approximately $5,556,000 increase in the deferred tax valuation allowance and an estimated $4,947,000 of income taxes associated with the conversion.

IC and its subsidiary incurred income tax expense of approximately $405,000 and $2,000 for the years ended September 30, 2014 and 2013, respectively. As of September 30, 2014, operating loss carry forwards for federal income tax purposes totaled approximately $505,000 and $22,712,000 for IC and BMC, respectively, which expire in various years ranging from 2015 to 2033. This results in a deferred tax asset; however, because utilization of these net operating losses is not reasonably assured, IC and BMC have recorded a full valuation allowance offsetting this deferred tax asset.

15. Funds held in trust by others

Baystate Health and its subsidiaries are beneficiaries of certain perpetual trusts (the "Trusts"), from which they receive unrestricted income. Appreciation or depreciation in the value of the Trusts is recorded as an increase or decrease to permanently restricted net assets. During fiscal years 2014 and 2013, distributions from the Trusts were approximately $2,072,000 and $1,451,000, respectively, and are included in operating revenue.

16. Benefit plans

Baystate Health and certain of its consolidated subsidiaries and other ownership interests participate in a noncontributory, defined benefit cash balance retirement plan (the "plan") covering substantially all of their eligible employees.

Baystate Health's policy is to fund amounts as are necessary on an actuarial basis to provide for benefits in accordance with the Employee Retirement Income Security Act of 1974, using the accrued benefit (net credit) actuarial cost method.

The following table presents the change in the plan's projected benefit obligation, change in plan assets, and funded status of the plan as of September 30, 2014 and 2013, net of unconsolidated other ownership interest (in thousands):

	2014	2013
Change in pension obligation		
Pension obligation at beginning of year	$ 823,568	$ 906,113
Service cost	27,840	33,036
Interest cost	41,202	37,132
Actuarial loss (gain)	73,261	(109,348)
Benefits paid	(52,382)	(41,253)
Plan amendments	-	(2,112)
Pension obligation at end of year	$ 913,489	$ 823,568
Change in plan assets		
Fair value of plan assets at beginning of year	$ 744,845	$ 724,745
Actual return on plan assets	81,255	21,353
Employer contributions	40,000	40,000
Benefits paid	(52,382)	(41,253)
Fair value of plan assets at end of year	$ 813,718	$ 744,845
Funded status		
Funded status of the plan	$ (99,771)	$ (78,723)
Pension liability	$ (99,771)	$ (78,723)
Amounts recognized in unrestricted net assets consist of		
Net actuarial loss	$ 317,178	$ 292,404
Prior service credit	(84,928)	(97,925)
Pension adjustment	$ 232,250	$ 194,479

Exclusive of other ownership interest, the underfunded status of the plan at September 30, 2014, is approximately $99,502,000; the change in the pension adjustment is $37,558,000; and the total pension liability is $231,272,000.

Exclusive of other ownership interest, the underfunded status of the plan at September 30, 2013, is approximately $78,552,000; the change in the pension adjustment is $92,316,000; and the total pension liability is $193,715,000.

The net actuarial loss and prior service credit expected to be recognized in benefit cost in 2014 is approximately $25,375,000 and $12,997,000, respectively.

The assumptions used to develop the projected benefit obligation as of September 30, 2014 and 2013, are as follows:

	2014	2013
Discount rate	4.45 %	5.05 %
Rate of compensation increase	3.00	3.00

The accumulated benefit obligation was approximately $856,277,000 and $780,075,000 at September 30, 2014 and 2013, respectively.

Net Periodic Pension Cost — Net pension cost for the defined benefit plan for the years ended September 30, 2014 and 2013, includes the following components (in thousands):

	2014	2013
Service cost	$ 27,840	$ 33,036
Interest cost	41,202	37,133
Expected return on plan assets	(56,242)	(57,254)
Amortization of prior service credit	(12,998)	(12,766)
Recognized net actuarial loss	23,475	30,046
Net pension cost	$ 23,277	$ 30,195

The assumptions used to determine net pension cost for the years ended September 30, 2014 and 2013, are as follows:

	2014	2013
Discount rate	5.05 %	4.10 %
Expected return on plan assets	7.75	7.75
Rate of compensation increase	3.00	3.25

Plan Assets — The plan's investment objectives are to achieve long-term growth in excess of inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets. In order to minimize risk, the plan attempts to minimize the variability in yearly returns. The plan diversifies its holdings among sectors, industries, and companies. The target allocations of assets at September 30, 2014, were equities 30%, fixed income 40%, and other 30%.

To develop the expected long-term rate of return on plan assets assumption, Baystate Health considered the historical return and the future expectations for returns for each asset class, as well as the target asset allocation of the pension investment portfolio.

Baystate Health's pension plan asset allocation by asset category as of September 30, 2014 and 2013, is as follows:

	2014	2013
Common and preferred equity securities	32 %	33 %
U.S. government and domestic fixed-income securities	40	37
Other investments	28	30
	100 %	100 %

Financial assets invested in Baystate Health's defined benefit pension plan (the "Plan"), in one of the three categories described previously, as of September 30, 2014 and 2013, are classified as follows (in thousands):

	Assets at Fair Value as of September 30, 2014			
	Level 1	Level 2	Level 3	Total
Money market	$ 1,995	$ 2,304	$ -	$ 4,299
Mutual funds:				
Corporate bond fund	175,946	-	-	175,946
Other	121,177	-	-	121,177
Total mutual funds	297,123	-	-	297,123
Common collective trusts:				
International equity	-	35,043	-	35,043
Domestic equity index funds	-	76,250	-	76,250
Total common collective trusts	-	111,293	-	111,293
Limited liability and partnership investments:				
Private equity funds	-	-	39,786	39,786
Real estate fund	-	-	10,213	10,213
Hedge funds	-	-	127,766	127,766
International equity	-	44,301	-	44,301
Emerging markets equity	-	14,488	-	14,488
Other	-	17,383	-	17,383
Total limited liability and partnership investments	-	76,172	177,765	253,937
Fixed-income securities — U.S. government securities	-	132,759	-	132,759
Total assets — at fair value	$299,118	$322,528	$177,765	799,411
Pension assets — at contract value				14,307
Total pension plan assets				$813,718

	Assets at Fair Value as of September 30, 2013			
	Level 1	**Level 2**	**Level 3**	**Total**
Money market	$ 3,184	$ 2,562	$ -	$ 5,746
Mutual funds:				
Corporate bond fund	153,979	-	-	153,979
Other	108,471	-	-	108,471
Total mutual funds	262,450	-	-	262,450
Common collective trusts:				
International equity	-	18,066	-	18,066
Domestic equity index funds	-	67,420	-	67,420
Commodity fund	-	30,267	-	30,267
Total common collective trusts	-	115,753	-	115,753
Limited liability and partnership investments:				
Private equity funds	-	-	37,707	37,707
Real estate fund	-	-	12,841	12,841
Hedge funds	-	-	116,585	116,585
International equity	-	60,532	-	60,532
Other	-	8,421	-	8,421
Total limited liability and partnership investments	-	68,953	167,133	236,086
Fixed-income securities — U.S. government securities	-	110,928	-	110,928
Total assets — at fair value	$265,634	$298,196	$167,133	730,963
Pension assets — at contract value				13,882
Total pension plan assets				$744,845

The following table sets forth a summary of changes in the fair value of the Level 3 assets for the years ended September 30, 2014 and 2013 (in thousands):

	2014 Level 3 Rollforward			
	Real Estate	**Hedge Funds**	**Private Equity**	**Total**
Balance at beginning of year	$ 12,841	$ 116,585	$ 37,707	$167,133
Unrealized gains relating to investments still held at the reporting date	448	11,192	1,927	13,567
Realized gain on investments sold	1,146	-	5,367	6,513
Net cash distributions	(4,282)	(11)	(8,340)	(12,633)
Purchases	60	-	3,125	3,185
Balance at end of year	$ 10,213	$ 127,766	$ 39,786	$177,765

	2013 Level 3 Rollforward				
	Real Estate	Hedge Funds	Private Equity	Emerging Markets	Total
Balance at beginning of year	$13,727	$112,234	$37,807	$20,456	$184,224
Correction of prior year error	-	-	-	(20,456)	(20,456)
Unrealized gains relating to investments still held at the reporting date	966	12,626	(908)	-	12,684
Realized gains on investments sold	521	(335)	4,308	-	4,494
Cash transfers	-	-	(313)	-	(313)
Sales	(2,373)	(7,940)	(3,187)	-	(13,500)
Balance at end of year	$12,841	$116,585	$37,707	$ -	$167,133

2012 Leveling Disclosure Errors Corrected in 2013 — During 2013, Baystate Health determined that there were errors in the classification of certain financial instruments within the fair value hierarchy presented for September 30, 2012. The classifications have been corrected out of period at the beginning of fiscal year 2013. A summary of the corrections is as follows (in thousands):

	Increase (Decrease)
Level 1	$ (167,289)
Level 2	187,745
Level 3	(20,456)

Transfers between Levels — The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. During 2013, certain limited liability and partnership investments were transferred from Level 3 to Level 2 due to the expiration of redemption restrictions. There were no transfers in or out from Level 3 in 2014.

A summary of investments (by major class) with a reported NAV that have restrictions on the Plan's ability to redeem its investment at the measurement date as of September 30, 2014 and 2013, is as follows (in thousands):

	September 30, 2014		
Description of Investment	**Fair Value**	**Redemption Frequency**	**Redemption Notice Period**
Commingled equity mutual funds	$ 130,863	Monthly	5 days
Commingled emerging markets funds	39,218	Monthly	15 days
Commingled commodity funds	17,383	Monthly	30 days
Hedge fund of funds	114,446	Annually	65-95 days
Hedge fund of funds	13,319	Every three years	65-95 days
Private market investments	49,998	*	*

	September 30, 2013		
Description of Investment	**Fair Value**	**Redemption Frequency**	**Redemption Notice Period**
Commingled equity mutual funds	$ 85,486	Monthly	5 days
Commingled emerging markets funds	21,252	Monthly	15 days
Commingled commodity fund	38,688	Monthly	30 days
Hedge fund of funds	116,585	Quarterly	60 days

***** Liquidity data not available, funds are considered to be highly illiquid.

Contributions — Baystate Health expects to contribute approximately $35,000,000 to its pension plan in 2015.

Estimated Future Benefit Payments — The following approximate benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next 10 calendar years (in thousands):

Calendar Year	**Pension Benefits**
2015	$ 83,700
2016	62,700
2017	63,600
2018	62,400
2019	61,700
Years 2020–2024	310,500
	$ 644,600

Defined Contribution Plans — Baystate Health and certain of its consolidated subsidiaries and other ownership interest participate in a defined contribution retirement plan, which covers all employees hired after December 31, 2004. Under this plan, Baystate Health contributes up to 7.5% of the employee's compensation based on age and years of service. Excluding the deferred compensation plan discussed below, total expense under this plan was approximately $11,694,000 in 2014 and $8,016,000 in 2013.

HNE provides a 401(k) retirement plan (the "Plan"). Each year, employees may contribute up to 75% of pretax annual compensation, as defined in the Plan document. HNE matches 100% of the first 6% of employee contributions to the Plan. Additional contributions may be made by HNE at its discretion. Contributions and compensation levels are subject to certain limitations under the Internal Revenue Code. The Plan expense amounted to approximately $1,558,000 and $1,418,000 in 2014 and 2013, respectively.

Deferred Compensation Plan — As a component of its defined contribution retirement plan, Baystate Health established a nonqualified deferred compensation plan, effective January 1, 2002, which allows certain highly compensated employees the option to defer specified amounts of their annual compensation on a pretax basis and also allows Baystate Health, at its discretion, the option to provide deferred compensation to key employees. A participant in the plan is notified if a voluntary contribution is made by Baystate Health to that participant's account. In addition, the participant's account is credited to reflect investment returns based on measuring investments selected by either the participant or the plan administrator in accordance with the plan document. The participant has the option to take a distribution of their account in its entirety, upon severance from employment with Baystate Health. Baystate Health has recorded $35,889,000 and $30,139,000 within other liabilities in the consolidated statements of financial position of as of September 30, 2014 and 2013, respectively, which represents its obligation for benefits payable under the plan. All amounts of compensation deferred under the plan remain the assets of Baystate Health until paid out to a participant or his or her beneficiary. Baystate Health is not required to segregate or set aside any assets to meet its obligation under the plan. Baystate Health's contributions amounted to approximately $1,160,000 and $1,032,000 in 2014 and 2013, respectively.

17. Concentrations of credit risk

Baystate Health and its subsidiaries grant credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at September 30, 2014 and 2013, is as follows:

	2014	2013
Medicare	22 %	20 %
Medicaid	16	15
Blue Cross	2	1
Health maintenance organizations	38	38
Commercial	12	12
Self-pay patients	10	14
	100 %	100 %

18. Functional expenses

Baystate Health and its subsidiaries provide general health care services to residents within their geographic location. Expenses related to providing these services for the years ended September 30, 2014 and 2013, are as follows (in thousands):

	2014	2013
Health care services	$1,692,025	$1,574,367
General and administrative	77,759	91,797
	$1,769,784	$1,666,164

19. Temporarily and permanently restricted net assets

Temporarily restricted net assets at September 30, 2014 and 2013, are available for the following purposes (in thousands):

	2014	2013
Research and education	$11,568	$11,705
Patient care services	43,043	43,070
Total	$54,611	$54,775

Permanently restricted net assets are invested in perpetuity, the income from which is generally expendable to support the delivery of health care services.

ASC 958-205, *Endowment of Not-for-Profit Organizations*, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Massachusetts enacted UPMIFA on July 2, 2009. Baystate Health is subject to ASC 958-205 disclosure requirements regarding its endowment funds.

Baystate Health's endowments consist of numerous individual funds established for a variety of purposes. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Baystate Health requires the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Baystate Health classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment funds that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure. Baystate Health considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (a) the duration and preservation of the fund, (b) the purpose of Baystate Health and the donor-restricted endowment fund, (c) general economic conditions, (d) the possible effect of inflation and deflation, (e) the expected total return from income and the appreciation of investments, and (f) the investment policies of Baystate Health.

Endowment net asset composition by type of fund as of September 30, 2014 and 2013, consisted of the following (in thousands):

As of September 30, 2014	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 37,843	$ 16,492	$ 54,335
Board-designated endowment funds	22,920	-	-	22,920
Endowment net assets at September 30, 2014	$ 22,920	$ 37,843	$ 16,492	$ 77,255

As of September 30, 2013	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 36,194	$ 16,327	$ 52,521
Board-designated endowment funds	22,088	-	-	22,088
Endowment net assets at September 30, 2013	$ 22,088	$ 36,194	$ 16,327	$ 74,609

For the year ended September 30, 2014, Baystate Health had the following endowment-related activities (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at October 1, 2013	$22,088	$36,194	$16,327	$74,609
Investment return:				
Investment income	167	80	-	247
Net appreciation	1,578	3,741	-	5,319
Total investment return	1,745	3,821	-	5,566
Contributions	102	-	5	107
Net asset reclassifications	-	(31)	-	(31)
Transferred in - Wing acquisition	-	-	160	160
Amounts appropriated for expenditures	(1,015)	(2,141)	-	(3,156)
Total change in endowment funds	832	1,649	165	2,646
Endowment net assets at September 30, 2014	$22,920	$37,843	$16,492	$77,255

For the year ended September 30, 2013, Baystate Health had the following endowment-related activities (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at October 1, 2012	$ 20,938	$ 33,926	$ 16,273	$ 71,137
Investment return:				
Investment income	135	323	-	458
Net appreciation	1,865	4,449	-	6,314
Total investment return	2,000	4,772	-	6,772
Contributions	171	-	54	225
Net asset reclassifications	-	(66)	-	(66)
Amounts appropriated for expenditures	(1,021)	(2,438)	-	(3,459)
Total change in endowment funds	1,150	2,268	54	3,472
Endowment net assets at September 30, 2013	$ 22,088	$ 36,194	$ 16,327	$ 74,609

Baystate Health's investment and spending policies for endowment assets are intended to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that Baystate Health must hold in perpetuity or for a donor-specified term. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that will generate an 8.5% over the long-term. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, Baystate Health relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Baystate Health targets a diversified asset allocation that consists of equities, fixed income, and alternative investments.

Baystate Health has a policy of appropriating for distribution each year, no more than 5% of its endowment funds' current fair value. In establishing this policy, Baystate Health considered the long-term expected return on its endowments.

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 Baystate Health to retain as a fund of perpetual duration. There was no deficiency of this nature at September 30, 2014 and 2013.

20. State surplus revenue retention

Through September 30, 2014, BMC had no surplus in excess of the Commonwealth of Massachusetts regulations governing the excess of state revenues over expenses for not-for-profit organizations. The total deficit attributable to state contracting for BMC was approximately $137,000 (2013 — $82,000). As of September 30, 2014, the cumulative deficit attributable to state contracting of approximately $6,399,000 is included in the unrestricted net assets of BMC.

21. Subsequent events

On October 1, 2014, BMC issued Series N MDFA Revenue Bonds in the aggregate principal amount of $55,115,000. The proceeds from the bonds will finance the build out of inpatient rooms, operating rooms, inpatient pharmacy, medical equipment, information technology equipment, and other capital projects. The bonds are 30 year bonds with final maturity on July 1, 2044. In connection with the construction project, BMC has entered into a construction contract in the amount of approximately $39,773,000.

On December 1, 2014, BFMC issued Series A MDFA Revenue Bonds in the aggregate principal amount of $22,000,000. The proceeds from the bonds will finance the construction of a new surgical unit at BFMC. The bonds are 30 years bonds with final maturity on December 4, 2044. BMC has entered into a guaranty agreement on behalf of BFMC in connection with this bond. In connection with the construction project, BFMC has entered into a construction contract in the amount of approximately $17,035,000.

Subsequent events have been evaluated for potential recognition in the consolidated financial statements through December 23, 2014, which is the date the consolidated financial statements were issued.

* * * * * *